



THE U.S. TRUSTEE PROGRAM'S EFFORTS TO PREVENT BANKRUPTCY FRAUD AND ABUSE

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EXECUTIVE SUMMARY

According to the United States Bankruptcy Court, bankruptcies are at an all-time high, with new filings reaching 1.5 million for the 12-month period ending June 2002. The Executive Office for U.S. Trustees (EOUST), through regional U.S. Trustees (UST), manages the bankruptcy system and is largely responsible for maintaining the integrity of the system. Collectively, the EOUST and the USTs constitute the U.S. Trustee Program. The UST Program is the "watchdog" over the entire bankruptcy process and is responsible for promoting the efficiency of the bankruptcy system and securing the just, speedy, and economical resolution of bankruptcy cases.

The Federal Bureau of Investigation (FBI) estimates that 10 percent of all bankruptcy filings involve fraud, especially evasion by debtors to fully disclose their assets. If so, there were about 100,000 cases of fraud in Calendar Year (CY) 2001. Because bankruptcy fraud and abuse by debtors, creditors, attorneys, and others threaten the integrity of the system, the UST Program's ability to deter and detect bankruptcy fraud and abuse and make criminal fraud referrals to law enforcement or to take civil action is critical to protecting the bankruptcy system.

The bankruptcy process is governed by Title 11, U.S. Code, known as the Bankruptcy Code. There are two basic types of bankruptcy filings: liquidation under Chapter 7 of the Code and rehabilitation of the debtor under Chapters 11, 12, and 13 of the Code. A brief description of bankruptcy under each Chapter follows.

- Chapter 7 allows the liquidation (sale) of personal or business assets to pay debts. A private trustee appointed by a UST to administer the debtor's estate distributes the proceeds to creditors. An eligible debtor may receive a discharge from his or her debts under Chapter 7, except for any debts that are prohibited from discharge by the Bankruptcy Code such as taxes, child support, and alimony payments.
- Chapter 11 of the Code allows a debtor, usually a business, to pay debts while continuing to operate. The debtor, often with the participation of creditors, creates a reorganization plan allowing the repayment of all or part of the debt. The debtor may generally

continue business operations pending reorganization, unless the court orders the appointment of a trustee.

- Chapter 12 of the Code allows eligible family farms to file for bankruptcy, reorganize the farm's business affairs, continue operating, and repay all or part of the farm's debts. A private trustee appointed by a UST typically serves as the trustee of the debtor's estate pending fulfillment of the debtor's repayment obligations under a plan confirmed by the U.S. Bankruptcy Court.
- Chapter 13 of the Code allows individual wage earners to reorganize their financial affairs under a repayment plan that must be completed within three to five years. To be eligible for Chapter 13 relief, an individual must have regular income and may not have more than a certain amount of debt, as set forth in the Code. A private trustee appointed by a UST typically serves as the trustee of the debtor's estate pending fulfillment of the debtor's repayment obligations under a plan confirmed by the Bankruptcy Court.

The UST Program consists of three major organization units: the EOUST, 21 regional offices each headed by a UST, and 95 field offices headed by an Assistant United States Trustee (AUST). The EOUST (1) provides general policy and legal guidance to the regional and field offices in their implementation of federal bankruptcy laws, and (2) oversees the Program's operations. Each UST is responsible for managing the field offices located within his or her region. The USTs' responsibilities include:

- appointing and supervising private trustees who administer Chapters 7, 11, 12, and 13 bankruptcy estates,¹ and
- taking legal action to enforce the requirements of the Bankruptcy Code and to prevent fraud and abuse.

Given the vulnerability of the bankruptcy system to fraud and abuse and the UST Program's stated key role to deter and detect such fraud and abuse — especially during the current period of escalating bankruptcies — the Office of the Inspector General (OIG) selected the UST Program for audit. The objectives of our audit were to assess: (1) the management controls implemented in UST offices to identify and eliminate fraud and misconduct by debtors, private trustees, and others, and (2) compliance

¹ In the event that the private trustee is unable or unwilling to serve, the U.S. Trustee may assume the private trustee's duties.

with the Government Performance and Results Act, which requires federal agencies to measure and report on their program performance.

To perform our audit, we interviewed EOUST officials in the Director's Office, Office of Review and Oversight, Office of Research and Planning, and Office of Administration. Additionally, we conducted interviews, reviewed documents, and analyzed information at 5 of the 21 UST regional offices: Atlanta, Chicago, Los Angeles, New York, and Philadelphia. We selected these five offices because collectively they referred about 56 percent of the Program's criminal fraud cases to law enforcement and provided a cross section of the Program's bankruptcy fraud and abuse control procedures and practices. We reviewed documents relating to pending bankruptcy legislation, fraud referral case files, civil enforcement case files, trustee performance evaluations, semiannual report reviews, trustee final and distribution report reviews, monthly operating reports, audits, UST field examinations, and training.

We found that the USTs rely substantially on the initiative of private trustees and on tips to detect most fraud. The UST Program has begun initiatives to target certain types of fraud, specifically the use of false identities or false social security numbers and also unscrupulous bankruptcy petition preparers. However, the UST Program does not have an ongoing, systematic process to identify vulnerabilities in the bankruptcy system and it has not established uniform internal controls to detect common, higher-risk frauds such as a debtor's failure to disclose all assets. In fact, the management controls in place did not address most of the fraud indicators identified in the UST Manual and instead focused primarily on fraud that might be committed by trustees and their employees rather than by debtors.

While such controls over trustee operations are necessary and are likely to contribute to deterring fraud and abuse by trustees and their employees — which accounted for less than one percent of UST referrals to law enforcement over the last 15 years — they do not focus on debtor and debtor-related fraud. As a result, the FBI's estimated 10 percent of bankruptcy cases that involve fraud may not be discovered, and the UST Program's mission to preserve the integrity of the bankruptcy system may not be accomplished as effectively as it should.

The primary methods used by the UST Program to deter and detect fraud are (1) private trustees' review of case information and (2) tips from ex-spouses, ex-business partners, creditors, and others, who could have a grievance with the debtor or who might be offended by the debtor's behavior and misuse of the bankruptcy system. Some UST regions do not rely as extensively on trustees and tips to detect fraud. Instead, these regions have

implemented their own fraud detection measures such as reviewing bankruptcy petitions and schedules of assets in an attempt to identify concealed property. In addition to criminal fraud referrals to law enforcement agencies, the UST Program has placed its highest priority on filing civil lawsuits against those who attempt to abuse the bankruptcy system, especially where criminal prosecution of a case is unlikely due to the lower dollar value of the case or where evidence may not be substantial. Although UST Program officials told us they never will be able to prevent or identify all instances of fraud and abuse, they stated that civil enforcement has been a successful initiative.

Although the USTs view private trustees — primarily Chapter 7 trustees — as the first line of defense in detecting bankruptcy fraud, the trustees do not always have the incentive, time, or initiative to review cases for potential fraud. Still, trustees are in a good position to help identify fraud and abuse in the bankruptcy system. For most debtors, the private trustee is the only bankruptcy official with whom the debtor will interact during the bankruptcy process. Also, trustees have access to debtors' petitions and schedules, and they can request additional information such as tax returns and bank statements. According to UST Program officials, trustees can discover fraud in several ways, such as:

- initial review of property schedules, statements of affairs, and statements of current income and expenses;
- review of records such as financial statements and records, Uniform Commercial Code filings and title searches, insurance records, divorce files, bank loan files, proofs of claim, and tax returns;
- interview of the debtor at a required meeting of creditors; and
- complaints or tips from third parties to the private trustee.

The AUSTs at the five regional offices we audited stated that in addition to the private trustees as the first line of defense against fraud, the UST Program relies substantially on complaints or tips from the public to detect instances of bankruptcy fraud. Because the UST Program data did not indicate what percentage of the UST referrals to law enforcement authorities were based on tips, we reviewed the fraud referrals made in FYs 1999 to 2001. We reviewed all the referrals made during these three

years, except in one large-volume² regional office where we sampled the referrals. In total, our sample included 302 referrals for the five regional offices that we audited. We reviewed the case files for each fraud referral to determine the method of detection. We found that about 48 percent of fraud referrals to law enforcement resulted from tips from creditors, ex-spouses, ex-partners, and victims. Other cases were mostly detected by private trustees and sometimes by the UST reviews of debtors' records. The predominant source of fraud cases was in Chapter 7 filings, which accounted for over 70 percent of all bankruptcy filings in 2001, although other Chapters were found to be vulnerable to fraud.

In addition to relying on the initiative of trustees and the public to identify and report suspected fraud, the UST Program has begun to emphasize civil lawsuits in addition to referrals for criminal prosecution. The UST Program refers to these civil lawsuits as civil enforcement actions. Civil enforcement action may be taken by the UST against a debtor without referring the case to a law enforcement agency for investigation. The USTs or another interested party must first identify the benefit of the fraud and then select the appropriate civil enforcement action to deny that benefit. The most common benefits of bankruptcy fraud include: (1) an automatic stay, which prevents a creditor from pursuing any action against the debtor or the property of the estate to collect or enforce a pre-petition debt; (2) a discharge, which removes the debtor's obligation to pay a debt; and (3) creditor inertia where a creditor writes off a debt upon learning that a bankruptcy case has been filed and abandons collection efforts even if the case is subsequently dismissed. In a civil lawsuit, the UST or other interested party files a motion or complaint with the court. A bankruptcy court judge hears the case and issues a court order outlining the findings of the court.

Another part of the UST Program's oversight responsibilities include establishing controls to ensure that trustees and their employees do not embezzle funds or misappropriate property from the bankruptcy estates entrusted to them. The management controls directly implemented by the UST Program are primarily designed to detect fraud committed by trustees and their employees rather than by debtors or others. The controls established by the Program to detect trustee-related fraud include: (1) review of the trustee's semiannual report, which provides information on the Chapter 7 trustee's financial management, internal controls, organizational effort and legal administration of cases administered by the

² The Los Angeles Regional Office made 2,834 referrals. Some USTs explained that other regions made fewer referrals because they screened out those less likely to be successfully prosecuted.

trustee; (2) review of cash receipts and disbursements reports; (3) review of the trustee final report, which certifies that all assets have been liquidated and are properly accounted for and that funds of the estate are available for distribution; (4) review of the trustee final account, which certifies that funds have been distributed to creditors; and (5) external audits³ and UST field examinations. Over the past 15 years (1986 through 2001), the Program made 71 referrals to the U.S. Attorneys for embezzlement by trustees or their employees, which accounts for less than one percent of total referrals during that period.

The UST Program established in 1988 a Criminal Referral Tracking System for performance measurement reporting and for monitoring fraud referrals to law enforcement authorities. However, we found that the tracking system, which depends on complete and accurate data submissions by UST regional offices, was materially inaccurate. The usefulness of the system for performance measurement and tracking of referrals was limited due to inaccurate, missing, or inconsistent data; lack of standard data protocols; and lack of review by UST and EOUST personnel to ensure the accuracy and completeness of the data. In addition, the system did not record data on the USTs' efforts to investigate bankruptcy fraud cases. Specifically, the system did not include cases that the USTs investigated but did not refer to law enforcement. As a result, the UST Program was not able to conduct complete and accurate trend analyses of fraudulent activity to help target program attention to the greatest risks. Also, the current data system and its data limitations may allow the UST Program, the Department, and Congress to rely on incomplete and inaccurate data in measuring the UST Program's performance and making funding and resource allocation decisions.

The 21 UST regional offices provide data on fraud referrals for input to the EOUST tracking system. The regional offices submit the data quarterly on spreadsheets designed by the EOUST. The EOUST performs a limited review of the 21 spreadsheets to ensure that the data fields are properly formatted so the spreadsheets can be downloaded into the EOUST's tracking system. However, the EOUST does not verify that the data is accurate, complete, or consistent. An EOUST staff member stated that the regions are responsible for ensuring the integrity of the data, because the regions maintain the supporting documentation. We found inconsistent and missing data in 19 of the 33 data elements in the tracking system. For example, regional offices used over 2,000 descriptions to identify the type of fraud. Also, in about 72 percent of cases the amount of loss due to fraud was not

³ The UST Program reimburses the OIG for auditing Chapter 7 trustees. The audits primarily test the trustees' internal controls and practices, but do not focus on fraud.

entered into the system, and in 46 percent of the cases there was no code to indicate the type of person (such as debtor or debtor's attorney) who was the subject of the referral. Further, the statute of limitations for the crime was almost never recorded to help ensure timely action.

To determine the accuracy of data submitted by individual UST regional offices, we analyzed the sample of 302 fraud referrals discussed previously. We reviewed the case file for each of the sampled referrals. The case files varied widely in size depending on the nature of the allegation and the complexity of the investigation. Our review of the supporting documentation for the regional offices' 302 fraud referrals determined that approximately 34 percent of the cases contained at least one error or omission and another 9 percent could not be verified due to missing files. Data for 102 referrals was incomplete or inaccurate because the regional offices either failed to enter the required data or entered erroneous data. Data errors included referral date, subject name, case disposition, status, referral source, amount of loss, bankruptcy case number, and the subject of the referral such as debtor or attorney. Data omitted included type of alleged fraud, referral source, amount of loss, name of subject, and bankruptcy case number.

Subsequent to the completion of our audit fieldwork, the UST Program began taking a number of actions to improve its data system, including issuing protocols to the field offices and placing the system under the supervision of a Chief Information Officer.

Limitations of the data system also affect the accuracy of the UST Program's performance measurement. The Program prepared a Performance Plan for FY 2002 and FY 2003, and incorporated the plan into its budget submission. The UST Program established a performance goal to ensure that parties adhere to the standards of the law and to police for embezzlement, fraud, and other abuses. To meet the performance goal, the Program developed several performance indicators. In accordance with Departmental policy,⁴ the Program did not establish targets for the number of criminal referrals and convictions but instead reported data on a prior-year basis. A recent performance plan stated that in FY 2001, the UST Program made 586 referrals to law enforcement and 45 referrals resulted in a conviction. However, the referral data is derived from the

⁴ The Department of Justice issued a policy letter in February 1999 stating that numerical targets would not be established for performance indicators relating to law enforcement activities such as arrests, indictments, convictions, and seizures. The Department created this policy out of concern that such targets could be seen as "bounty hunting."

Criminal Referral Tracking System, which we have found materially unreliable due to errors, inconsistencies, and omissions.

Among the recommendations we make to the Director, Executive Office for U.S. Trustees, are:

- Establish a uniform system of management controls to prevent and detect the more common and higher risk frauds such as concealment of assets.
- Ensure uniform, complete, and timely reviews of trustee's reports.
- Provide specific guidance, performance expectations, and enhanced training for trustees if they are to bear primary responsibility for preventing and detecting fraud.
- Improve the accuracy, completeness, and consistency of the data in the National Tracking and Management System.
- Establish a nationwide data system, or adapt an existing data system, to track civil enforcement actions.

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BACKGROUND

Authorities

The Bankruptcy Reform Act of 1978 (11 USC § 101, et seq.) established a pilot U.S. Trustees Program to correct conflicts of interest and enhance the integrity of the bankruptcy system. The Bankruptcy Judges, U.S. Trustees, and the Family Farmer Bankruptcy Act of 1986 expanded the Program from a pilot effort involving 18 districts to a permanent national effort involving 21 regions with offices that mirrored the federal judicial districts.⁵

According to its mission statement, the UST Program is designed to:

- promote the efficiency, and protect and preserve the integrity of the bankruptcy system;
- work to secure the just, speedy, and economical resolution of bankruptcy cases;
- monitor the conduct of parties and take action to ensure compliance with applicable laws and procedures;
- identify and investigate bankruptcy fraud and abuse; and
- oversee administrative functions in bankruptcy cases.

Title 11 of the U.S. Code, known as the Bankruptcy Code (Code), and the Federal Rules of Bankruptcy Procedure govern bankruptcy filings. There are two basic types of bankruptcy filings: liquidation under Chapter 7 of the Code and rehabilitation of the debtor under Chapters 11, 12, and 13. According to the United States Bankruptcy Court, there were 6.9 million bankruptcy filings under these four chapters for calendar years 1997 through 2001. The trend in bankruptcy filings is upward. New bankruptcies filed during the second quarter of 2002 and for the previous 12 months set all-time records. New filings for a 12-month period ending June 2002 reached 1.5 million for the first time. The majority of bankruptcies are filed under Chapter 7 of the Code.

⁵ The exceptions are the judicial districts of Alabama and North Carolina, which elected to operate a separate bankruptcy administration program.

Bankruptcy Chapters and Filings

Debtors may file for relief under one of four Chapters of the Code: Chapter 7 involves the liquidation of personal or business assets to satisfy debts; Chapter 11 is used by businesses that want to continue operating while paying debts; Chapter 12 allows family farms to continue operating while paying debts; and Chapter 13 allows wage earners to reorganize their financial affairs under a repayment plan. The four Chapters are described in greater detail below.

Over the past five calendar years, the number of bankruptcy filings of all types has exceeded six million. The following table shows the number of filings by bankruptcy Chapter for each year. In 2001, total bankruptcies filed reached an all time high, increasing 19 percent (238,669) over 2000. Bankruptcy filings increased for all chapters except Chapter 12, which decreased by about 6 percent (24). The largest increase, about 23 percent (195,755), was in Chapter 7 filings. Partial data for 2002 indicates that the rate of bankruptcy filings continues to increase, reaching about 1.5 million new filings over a 12-month period ending in the second quarter of 2002.

Bankruptcy Filings by Chapter of the Bankruptcy Code Calendar Years 1997 through 2001					
Year	Chapter 7	Chapter 11	Chapter 12	Chapter 13	Total
1997	989,372	10,765	949	403,025	1,404,111
1998	1,035,696	8,386	807	397,619	1,442,508
1999	927,074	9,315	834	382,214	1,319,437
2000	859,220	9,884	407	383,894	1,253,405
2001	1,054,975	11,424	383	425,292	1,492,074
Total	4,866,337	49,774	3,380	1,992,044	6,911,535

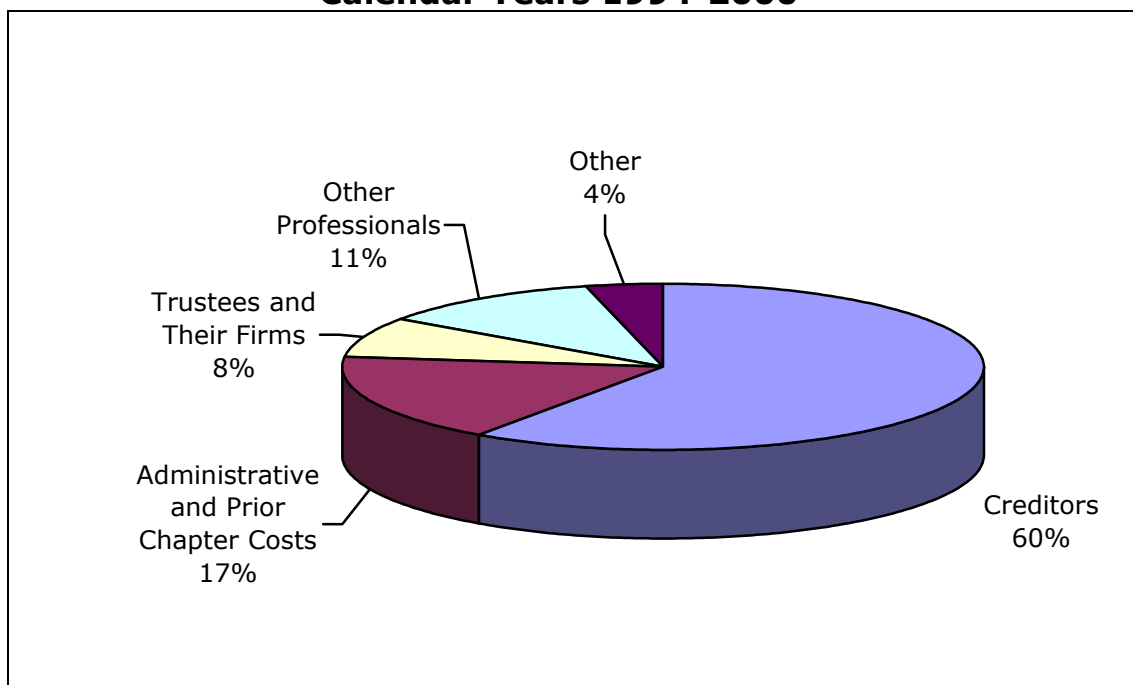
Source: United States Bankruptcy Court

Chapter 7 of the Code allows the liquidation (sale) of personal or business assets to pay debts. In a Chapter 7 liquidation proceeding, assets that are not exempt from creditors by law are collected and sold. A private trustee appointed by a U.S. Trustee to administer the debtor's estate distributes the proceeds to creditors. An eligible debtor may receive a discharge from his or her debts under Chapter 7, except for any debts that are prohibited from discharge by the Bankruptcy Code such as taxes, child support, and alimony payments. As shown in the table above, the vast majority of bankruptcy filings are under Chapter 7 (70 percent of bankruptcy

filings in 2001), although Chapter 13 results in almost twice as many dollars collected from debtors.

According to UST Program information, between calendar years 1994 and 2000, the total amount of receipts collected for Chapter 7 bankruptcy cases was \$10.5 billion. UST Program officials were unable to provide us with the total of the original debt. As shown in following chart, 60 percent of the receipts over the seven-year period, or \$6.3 billion, was distributed to creditors. The remainder of the receipts covered administrative and prior bankruptcy chapter costs, costs of trustees and their firms, fees of professionals, and other disbursements (including surplus funds returned to debtors, non-estate funds paid to debtors or third parties, and debtor exemptions).

**Disbursements of Chapter 7 Receipts
Calendar Years 1994-2000**



Source: EOUST

According to UST Program information, historically 95 percent of Chapter 7 cases are cases where no money is returned to creditors. These cases are commonly known as "no-asset" cases. Chapter 7 private trustees receive \$60 for administering a "no-asset" case. In cases where money is returned to creditors (asset cases), the Chapter 7 trustees may receive

substantial fees for administering the case. In asset cases, trustees received the \$60 plus compensation for services rendered as trustee.⁶

Chapter 11 of the Code allows a debtor, usually a business, to pay debts while continuing to operate. The debtor, often with the participation of creditors, creates a reorganization plan allowing the repayment of all or part of the debt. The debtor may generally continue business operations pending reorganization, unless the court orders the appointment of a trustee. In Chapter 11 cases the USTs are responsible for appointing and convening the creditors' committees and reviewing monthly operating reports. Chapter 11 filings were less than one percent of total bankruptcy filings in 2001. Information on collections and disbursements under Chapter 11 was not readily available in UST Program information. Chapter 11 debtors are required to pay quarterly fees to the UST Program until the case is closed, dismissed, or converted to another Chapter. The Chapter 11 debtor pays between \$250 and \$10,000 to the UST Program based on the total amount disbursed during the quarter. If there are no disbursements made during the quarter, the minimum fee of \$250 must still be paid. For FYs 1997 to 2001, the UST Program collected \$361 million in quarterly fees, an average of \$18 million per quarter.

Chapter 12 of the Code allows eligible family farms to file for bankruptcy, reorganize the farm's business affairs, continue operating, and repay all or part of the farm's debts. In 2001, the number of Chapter 12 filings represented an inconsequential fraction of a percentage of total bankruptcy filings. From FY 2001, the Chapter 12 trustees collected \$39.7 million in debtors' payments, of which \$31.3 million was paid to creditors. The remaining \$8.4 million was distributed to Chapter 12 trustees for compensation, administrative expenses, and professional fees. A private trustee appointed by a UST typically serves as the trustee of the debtor's estate pending fulfillment of the debtor's repayment obligations under a plan confirmed by the U.S. Bankruptcy Court. A Chapter 12 trustee is compensated based on level five of the federal executive salary schedule or five percent of payments, whichever is less.

Chapter 13 of the Code allows individual wage earners (consumers) to reorganize their financial affairs under a repayment plan that must be completed within three to five years. To be eligible for Chapter 13 relief, a

⁶ The maximum allowable trustee compensation is not to exceed 25 percent on the first \$5,000 or less, 10 percent on any amount in excess of \$5,000 but not in excess of \$50,000, 5 percent on any amount in excess of 50,000 but not in excess of \$1 million, and reasonable compensation not to exceed 3 percent of such moneys in excess of \$1 million, of all moneys disbursed or turned over in the case by the trustee.

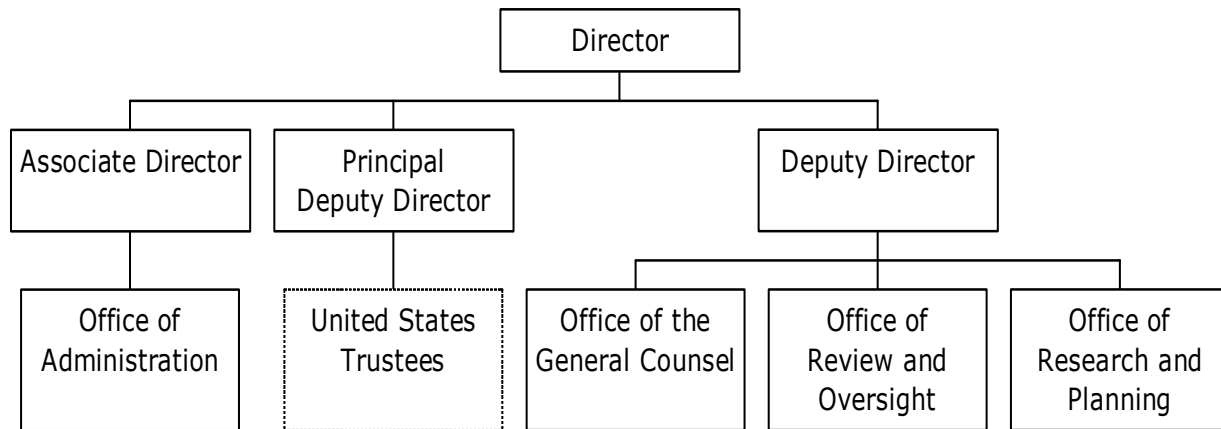
consumer must have regular income and may not have more than a certain amount of debt, as set forth in the Bankruptcy Code. About 29 percent of total bankruptcy filings in 2001 were under Chapter 13. However, collections of debtors' payments were almost twice as much as receipts collected under Chapter 7, although Chapter 7 had over twice as many bankruptcy filings. From FY 1994 through 2001, the Chapter 13 trustees collected \$19 billion in debtors' payments, of which \$15.4 billion was paid to creditors. The remaining \$3.6 billion was distributed to Chapter 13 trustees for compensation, administrative expenses, and professional fees. A private trustee appointed by a UST typically serves as the trustee of the debtor's estate pending fulfillment of the debtor's repayment obligations under a plan confirmed by the Bankruptcy Court. Chapter 13 trustee compensation is similar to that of Chapter 12 trustees, described above.

UST Program Organization

The UST Program has three major organizational units: the Executive Office for U.S. Trustees (EOUST), 21 regional offices headed by USTs, and 95 field offices headed by Assistant United States Trustees (AUSTs).⁷ The following chart shows the organizational structure of the UST Program.

⁷ A table showing the 21 regional and 95 field offices is included in Appendix 4.

United States Trustee Program Organizational Structure



Boston	Cedar Rapids
New York	Kansas City
Philadelphia	Phoenix
Columbia	San Diego
New Orleans	Los Angeles
Dallas	San Francisco
Houston	Seattle
Memphis	Denver
Cleveland	Wichita
Indianapolis	Atlanta
Chicago	

Source: EOUST

Responsibilities of the EOUST and USTs

The EOUST, under a Director appointed by the Attorney General, provides general policy and legal guidance to the UST Program's regional and field offices in their implementation of federal bankruptcy laws and also oversees the UST Program's operations and administrative functions.

Each UST, also appointed by the Attorney General, is responsible for managing the field offices located within his or her region. Specifically, USTs are responsible for:

- appointing and supervising private trustees who administer Chapters 7, 12, and 13 bankruptcy estates and directly serving as a trustee in cases where private trustees are unable or unwilling to serve;

- taking legal action to enforce the requirements of the Code and preventing fraud and abuse;
- referring cases for investigation and criminal prosecution;
- ensuring that bankruptcy estates are administered promptly and efficiently and that professional fees are reasonable;
- appointing and convening creditors' committees⁸ in Chapter 11 business reorganization cases;
- reviewing disclosure statements and applications for the retention of professionals such as attorneys; and
- advocating matters relating to the Code and rules of procedure in court.

Responsibilities of Private Trustees

The UST appoints nearly all private trustees.⁹ As of March 2002, there were 2,665 private trustees nationwide. The following chart shows the number of private trustees by chapter.

United States Trustee Program Trustees As of March 2002	
Chapter	Number of Trustees
CHAPTER 7	1,544
CHAPTER 11	879
CHAPTER 12	54
CHAPTER 13	188
TOTAL	2,665

Source: EOUST

⁸ A creditors' committee generally consists of three to eleven unsecured creditors. The creditors' committee may consult with the Program, debtors, and others on matters affecting the administration of the estate.

⁹ Creditors may elect Chapter 7 and Chapter 11 trustees.

Chapter 7 Trustees

The principal responsibility of a Chapter 7 trustee is to collect and liquidate the property of a bankrupt estate and distribute the proceeds to creditors. According to the Code, Chapter 7 trustees' responsibilities are to:

- collect and sell estate property and close the estate as expeditiously as possible;
- assume accountability for all property received;
- ensure that the debtor surrenders estate property that secures consumer debts;
- investigate the financial affairs of the debtor;
- object to any improper claims on the estate;
- oppose the premature discharge of the debtor (but not the discharge of a particular debt, since only the creditor to whom it is owed may do so);
- furnish information concerning the estate and the estate's administration as requested by interested parties unless ordered otherwise by the court;
- for authorized operating businesses of the debtor, file with the court, UST, or any governmental unit responsible for collecting or determining tax liability, periodic reports and summaries including statements of receipts and disbursements; and
- file final reports (TFRs) and final accounts (TDRs) of the administration of the estate with the UST and the court.¹⁰

Chapter 11 Trustees

The court may direct the UST to appoint a Chapter 11 trustee upon the request of an interested party or the UST. A Chapter 11 trustee is appointed if:

¹⁰ TFRs and TDRs are reports filed by trustees before and after the distribution of funds to creditors, respectively.

- management is accused of fraud, dishonesty, incompetence, or gross mismanagement either before or after the commencement of the case; or
- such appointment is in the interest of creditors, any equity security holders, and other interests of the estate.

Chapter 11 trustees are to:

- be accountable for all property received;
- examine proofs of claims and object to the allowance of any improper claims;
- furnish information concerning the estate and the estate's administration as requested by a party in interest, unless the court orders otherwise;
- file with the court, UST, and any governmental unit with responsibility for collection or determination of any tax arising out of the operation, periodic reports and summaries of the operation of the business, including a statement of receipts and disbursements, and such other information as the UST or the court requires;
- make a final report and file a final account of the administration of the estate with the court and the UST;
- file the list, schedule,¹¹ and statement if the debtor has not done so;
- investigate the acts, conduct, assets, liabilities, and financial condition of the debtor, the operation of the debtor's business and the desirability of the continuance of the business, and any other matter relevant to the case or to the formulation of a reorganization plan;
- file a reorganization plan, a report of why the trustee will not file a reorganization plan, or recommend conversion or dismissal of the case;

¹¹ Debtors use bankruptcy schedules to report all assets and liabilities.

- furnish, without personal liability, tax returns not filed by the debtor; and
- file any report necessary or as the court orders after confirmation of a plan.

In lieu of appointing a trustee, the court may appoint an examiner to conduct an investigation of the debtor as appropriate. The investigation may include allegations of fraud, dishonesty, incompetence, misconduct, mismanagement, or irregularity in the management of the affairs of the debtor by current or former management. An examiner may be appointed if one of the two following conditions exists:

- the appointment is in the best interest of creditors, any equity security holders, and other interests of the estate; or
- the debtor's fixed, liquidated, unsecured debts – other than debts for goods, services, or taxes – exceed \$5,000,000.

Chapters 12 and 13 Trustees

Most Chapters 12 and 13 trustees are known as standing trustees. Their responsibilities are the same as Chapter 7 trustees except that they also:

- appear at any hearing concerning the value of the property subject to a lien, confirmation of a plan, or modification of a plan after confirmation;
- assist the debtor in executing the plan;
- ensure that the debtor makes payments;
- investigate the acts, conduct, assets, liabilities, and financial condition of the debtor, the operation of the debtor's business and the desirability of continuing the business, and any other matter relevant to the case or to the formulation of a plan if the debtor is engaged in business; and
- disburse to creditors funds collected from debtors pursuant to the terms of the confirmed plan.

UST Program Funding and Expenditures

The UST Program is entirely funded by fees assessed against debtors who use the bankruptcy system. Fees established by statute are deposited in the U.S. Trustee System Fund (Fund). Revenue for the UST Program is also generated from interest on Fund balances invested in U.S. Treasury notes and bills, Chapter 7 case administration receipts, excess compensation of Chapters 12 and 13 trustees, and collections of outstanding receivables that have been referred to the Department of the Treasury for debt collection. The Congress appropriates a portion of the fees for use by the UST Program. For FY 2001, the UST Program deposited \$151 million into the U.S. Trustee System Fund and was appropriated \$126 million.

Two categories of fees generate most of the revenue for the fund. The first category, providing \$61 million or 40 percent of the UST Program's funding in FY 2001, consists of fees paid by debtors at the inception of cases under Chapters 7, 11, 12, and 13. The second category, providing \$82.5 million or 55 percent of the UST Program's funding is the quarterly fees paid by Chapter 11 debtors. The other \$7.4 million or 5 percent comes from miscellaneous compensation associated with Chapters 12 and 13, debt collection receipts, and refunds.

In FYs 1997 to 2002, the UST Program obligated about \$739 million in total to manage and provide oversight of the bankruptcy system. The UST Program classifies the funds into two categories – Administration of Cases and Management and Administration. The Administration of Cases category includes the cost of administering all bankruptcy cases filed within the 95 field offices. The Management and Administration category includes the cost to maintain the EOUST in Washington. In FY 2002, the UST Program's budget increased nearly 21 percent over FY 2001. The following table shows the distribution of obligated funds between the two categories and the totals by year.

Funds Obligated by the UST Program FYs 1997 to 2002			
Category	Administration of Cases	Management and Administration	Total
1997	\$ 99,569,000	\$ 8,202,000	\$107,771,000
1998	\$108,540,000	\$ 9,001,000	\$117,541,000
1999	\$110,737,000	\$ 8,872,000	\$119,609,000
2000	\$110,706,000	\$10,843,000	\$121,549,000
2001	\$117,735,000	\$ 8,750,000	\$126,485,000
2002	\$145,717,000	\$0*	\$145,717,000
Total	\$693,004,000	\$45,668,000	\$738,672,000

Source: Obligations for FYs 1997 to 2001 according to UST budget documents, and obligated funding for FY 2002 according to UST Program officials.

* Per JMD guidance, as part of a Government Performance and Results Act initiative, the UST Program was directed to merge the Management and Administration decision unit into the Administration of Cases decision unit.

According to UST Program officials, for FY 2002 Congress appropriated \$6.3 million to fund 104 positions for fraud and civil abuse initiatives, \$3.7 million for 55 positions to address additional bankruptcy caseload, and nearly \$2 million for 5 automation positions, hardware, and facilities security. In addition, the UST Program received an additional \$2.8 million for mission-critical automation projects from the unobligated balances in the Department's Working Capital Fund.

For FY 2002 the UST Program had requested \$7.8 million for a fraud and an abuse initiative, \$7.3 million for hardware and software upgrades for the UST Program's Automated Case Management System (ACMS) and electronic case filing,¹² and \$3.7 million to deal with the increase in bankruptcy filings. Of the \$7.8 million requested for fraud and abuse initiatives, \$1 million was for a Bankruptcy Fraud Initiative and \$6.8 million was for an Abuse Litigation Initiative. The purpose of the Bankruptcy Fraud Initiative was to establish a Bankruptcy Fraud Team, consisting of 12 new attorney positions, to serve each of the 11 judicial circuits and the

¹² The Bankruptcy Courts started requiring that all cases be filed electronically with courts nationwide by the close of FY 2002. Both filing and examining cases are to be done electronically through the internet. The Electronic Case Filing gives the UST Program and others the ability to review the text of all filed documents but does not give the ability to capture and manipulate the information.

Washington, D.C. area. The team was expected to help identify bankruptcy fraud and support the prosecutorial efforts of federal law enforcement authorities. The purpose of the Abuse Litigation Initiative was to hire 36 attorneys, 24 bankruptcy analysts, 24 paralegals, and 28 clerks to identify debtors abusing the bankruptcy system. The initiative will target those who file under Chapter 7 but who may have sufficient income to sustain a Chapter 13 repayment plan. The UST Program was in the process of hiring the additional staffing during our audit.

Training

UST Employees

The UST Manual emphasizes the need for UST personnel to be trained in the criminal aspects of bankruptcy law so that they may effectively respond to complaints, discover criminal activity, and promptly refer criminal matters to the proper authorities. In FY 1999, the UST Program established the National Bankruptcy Training Institute (Institute) located in Columbia, South Carolina. The Institute's courses were designed with assistance from the American Bankruptcy Institute, National Association of Bankruptcy Trustees, National Bankruptcy Fraud Working Group, and law enforcement agencies. The Institute provides a three-day course on bankruptcy fraud and civil enforcement to AUSTs, Attorneys, Bankruptcy Analysts, and Paralegals. The course, entitled "Bankruptcy Fraud: Civil and Criminal Enforcement," covered:

- overview of the criminal justice system,
- uncovering evidence of fraud and abuse,
- health care fraud and bankruptcy,
- serial filers,
- fraudulent petition preparers,
- cooking the books, and
- identity fraud.

As of February 2002, 421 of the 701 eligible employees, or 60 percent, had received fraud training. A detailed listing of the number of employees who received training, by regional office, is included in Appendix 5.

Panel and Standing Trustees

The UST Program requires that Chapter 7 trustees receive at least one hour of training on criminal fraud every three years. The training is to cover the basic criminal bankruptcy statutes and preparation of fraud referrals. The UST Program has not established a specific bankruptcy fraud training requirement for the other chapter trustees. However, the USTs at the five regional offices we audited provided annual bankruptcy fraud training to all trustees.

Prior Audit Reports and Studies

We identified and reviewed one prior Office of the Inspector General (OIG) report and one Departmental study related to certain aspects of this audit, primarily UST oversight of bankruptcy trustees. We did not identify any relevant reports by the U.S. General Accounting Office.

In the OIG's September 1992 audit report, "Monitoring of Private Trustees" (92-19), we reviewed the EOUST's and the UST's (1) reporting and monitoring of private trustees, and (2) follow up on private trustee deficiencies and indications of fraud. We found that the UST regions had procedures for monitoring private trustees' bonding, reporting, and case closing and for following up on Chapter 7 reviews. However, the quality of monitoring varied by region and sometimes among field offices within regions. We concluded that the EOUST had limited assurance of trustee propriety because its oversight of trustee reviews and audits needed improvement. The report recommended that the EOUST issue national policy directives setting forth (1) minimum standards that UST regions must follow in documenting, assessing, and disposing of fraud allegations against trustees, and (2) guidelines for use by UST personnel to detect fraudulent trustee activities. Among the other findings discussed in the report were:

- UST regions were not rigorously following up on correction of trustee deficiencies identified by external reviews,
- over one-third of sampled panel trustees submitted incorrect or incomplete semiannual reports, and
- the EOUST lacked an effective method for gathering and compiling program statistics to ensure accurate data.

The EOUST implemented the two recommendations by including in the UST Manual the minimum standards for documenting, assessing, and

disposing of fraud allegations against trustees and by establishing protocols for regions to follow in dealing with suspected embezzlement and reconstructing the trustee's records.

At the request of the EOUST Director, the Management and Planning Staff (MPS) of the Department's Justice Management Division reviewed UST oversight and management of Chapters 7 and 13. The MPS based its review on interviews at the EOUST and 17 field offices and three other federal agencies. The MPS's October 1999 report, "A Management Review of the U.S. Trustee Program Chapter 7 and 13 Bankruptcy Oversight Processes," stated:

Most staff felt that all [emphasis is original] of the current oversight activities are needed to minimize the risks and were not able to set priorities on efficacy or probability. Disagreement exists on the proper mix of techniques to deter or detect crime and abuse. To figure out the most efficient mix of oversight activities, assessing the risk inherent to the current system is essential and to decide the amount of risk acceptable to USTP [U.S. Trustee Program] managers. The EOUST should conduct a formal analysis of its program risks, along with an assessment of the cost/benefit of certain prevention techniques.

The MPS report also stated the following.

- Interviewees were satisfied with existing Chapter 7 oversight activities but suggested some changes such as improved trustee training and more face-to face contact with trustees. Interviewees also suggested changes in UST reviews of trustees' financial reports.
- The Chapter 13 process is satisfactory, but some interviewees thought that oversight of case administration and trustees needed improvement. Some respondents said that the program was ripe for fraud and abuse.
- Addressing some overarching management concerns would provide significant efficiency gains for Chapters 7 and 13 oversight activities. For example, a more robust and user-friendly information system was needed and there should be greater use of sampling techniques in reviewing trustee reports.

The MPS recommended that the UST Program take the following actions.

- Develop an “Anti-Petition Preparer Initiative” that includes creating a national database of petition preparers to aid in the detection of fraudulent activity.
- Provide a nationwide database of cases to help in the detection of potential fraud, waste, and abuse.
- Obtain the expertise of an outside agency or contractor to conduct a study to determine the amount and extent of debtor fraud in Chapter 7 and 13 bankruptcies, as a key element of risk analysis.

The EOUST has partially implemented the MPS recommendations. Specifically, in January 2002 the EOUST established a petition preparer database tracking system. The database tracking system is discussed in more detail later in this report. The EOUST has not developed a nationwide database of cases to help with the detection of potential fraud, waste, and abuse. However, some regional offices have designed their own tracking systems, both manual and electronic. In one office we audited, the regional staff developed five separate tracking systems to report and track cases. Lastly, at the time of our audit the EOUST had not obtained the expertise of an outside agency or hired a contractor to determine the amount and extent of debtor fraud in Chapters 7 and 13 bankruptcies. As a result, three years after the MPS report UST Program officials told us that they do not know the extent of fraud in the bankruptcy system. Others in the bankruptcy system such as bankruptcy judges, trustees, and national creditor organizations have urged the UST Program to do more to identify fraud because fraud may be increasing with the rise in the number of bankruptcy filings.

FINDINGS AND RECOMMENDATIONS

FINDING 1: MANAGEMENT CONTROLS

The UST Program has begun some initiatives to target certain types of fraud and has made civil enforcement — in addition to criminal referrals to law enforcement — its number one priority. However, the UST Program relies substantially on the initiative of private trustees and on tips to detect most fraud. Moreover, the UST Program does not have an ongoing, systematic process to identify vulnerabilities in the bankruptcy system and establish uniform internal controls to detect common, high-risk frauds such as a debtor's failure to disclose all assets. In fact, the management controls in place did not address most of the fraud indicators identified in the UST Manual and focused primarily on fraud that might be committed by trustees and trustees' employees. While such controls over trustee operations are necessary and likely contribute to deterring fraud and abuse by trustees and their employees — which accounted for less than one percent of UST referrals to law enforcement over the last 15 years — these controls do not focus on other, higher-risk sources of fraud. As a result, bankruptcy fraud may not be discovered, and the UST Program's mission to preserve the integrity of the bankruptcy system may not be accomplished as effectively as possible.

Department's Emphasis on Fraud

Bankruptcy fraud threatens the integrity of the bankruptcy system because the system depends on full disclosure by debtors, creditors, and professionals in order to resolve disputes and to distribute money and property. The protection and integrity of the bankruptcy system is dependent upon the UST Program identifying bankruptcy fraud and abuse and taking appropriate actions.

In an October 1995 memorandum, the Attorney General emphasized the need for Departmental components to work together for the successful prosecution of bankruptcy fraud cases. The Attorney General stated in the memorandum:

[I]t is imperative that the integrity of the bankruptcy system, an integral component of our national economy, be preserved

and enhanced. Debtors who conceal assets, trustees who administer estates to their own improper advantage and professionals who run bankruptcy mills and other schemes involving the bankruptcy laws all undermine our faith in the integrity of the system.

The Attorney General identified the basic components essential to a successful bankruptcy fraud effort: training, a team approach and coordination of all available resources, and prosecutorial discretion that focuses on the merits of a case rather than a blanket declination policy based solely on dollar amount.

Bankruptcy Fraud Task Groups

In response to the Attorney General's memorandum, the UST Program began establishing interagency Bankruptcy Fraud Task Groups (Task Groups)¹³ and at the time of our audit had established Task Groups in 66 of the 95 UST field offices. The Task Groups were formed to aid in the successful prosecution of bankruptcy fraud cases by meeting periodically to discuss potential and actual bankruptcy fraud referrals, allow unproductive cases to be set aside and productive referrals brought to resolution quickly, and allow all parties to keep up to date of the status of the cases. Task Groups include members from UST offices, U.S. Attorney's Offices, the FBI, and other federal agencies such as the Internal Revenue Service and the Social Security Administration.

We spoke with the UST, FBI, and U.S. Attorney's representatives of the Task Groups for the five regional offices we audited. Before the September 11, 2001, terrorist attacks, the Task Groups met quarterly or semiannually to discuss cases. Since then, the Task Groups have not met regularly. According to the representatives, resources within the law enforcement agencies have been shifted to other priorities. In addition, most representatives told us that the establishment of the Task Groups had not necessarily aided in the successful prosecution of bankruptcy fraud cases. The National Bankruptcy Fraud Tracking System (discussed in Finding 2 of this report) showed that since FY 1995, 482 convictions resulted from the 6,090 fraud referrals made by the UST Program, or 8 percent. Between FYs 1988 and 1995, 355 convictions resulted from 1,474 fraud referrals, or 24 percent. No data was available to show how many convictions resulted from Task Groups' involvement. However, some

¹³ The USTs could not provide us the dates for the establishment of the Task Groups.

Task Group representatives said that the Task Groups remain beneficial because the groups allow sharing of information about bankruptcy fraud with other federal law enforcement agencies.

Fraud Indicators

The UST Program has identified in the UST Manual a detailed list of fraud indicators and the most common fraud schemes perpetrated by debtors, creditors, petition preparers, and others. Examples of the types of fraud indicators and schemes are shown in the following table. A complete listing of the fraud schemes and indicators appears in Appendix 6.

<u>Fraud Scheme</u>	<u>Fraud Indicators</u>
Concealment and False Statements	<ul style="list-style-type: none"> • Claims of theft or large gambling losses just before bankruptcy • Inability to account for property listed on insurance policies or personal financial statements in existence before bankruptcy • Incomplete schedules - frequent amendments in response to creditor questions • Unexplained change in financial circumstances • Debtor shows no ownership interest in residence • Tax returns not filed for the relevant years • Unsecured debt does not reconcile with assets listed, <u>e.g.</u>, large number of medical bills, but no lawsuit listed • Failure to list prior bankruptcies • Significant amendments to list of creditors after the Section 341 meeting of creditors¹⁴ • Complaints by ex-employees, ex-spouses, or ex-partners about hidden or omitted assets • Fifth Amendment claimed on any issue • Fire or other disaster occurs (of particular importance if arson is suspected) • Transfer of property to relatives or friends just before bankruptcy • Sudden appearance of loans or loan repayments to friends or relatives with little or no documentation • Sudden change of attorney for no apparent reason • Debtor "confused" about his/her assets and financial affairs
Serial Filers	<ul style="list-style-type: none"> • Debtor has filed a high number of cases in a short period of time • Debtor does not disclose prior bankruptcy cases

¹⁴ The Bankruptcy Code Section 341 meeting of creditors allows creditors, trustees, and other parties of interest to question debtors about the debts and assets of the estate.

- Debtor uses different counsel to file each case
- Chapter 13 cases never completed because of failure to fund plan
- Debtor had been prohibited from filing a case pursuant to 11 U.S.C. § 109(g)

A fraud indicator could be present in situations where there is no fraud. The USTs, trustees, and law enforcement officials must conduct an investigation to determine if a prosecutable fraud exists.

The UST Program's Methods Of Combating Fraud

The UST Program relies substantially on trustees to monitor for fraud and also on tips from ex-spouses, ex-business partners, creditors, and others. Based on information developed by trustees or through tips, the UST can investigate the circumstances and refer fraud cases to law enforcement agencies or to U.S. Attorneys for potential criminal prosecution. The management controls implemented directly by the USTs do not address most of the fraud schemes and indicators identified in the UST Manual but instead emphasize deterring and detecting fraud by trustees against bankruptcy estates. However, some UST regions do not rely as extensively on trustees and tips — even though tips are a valuable tool — to detect fraud by debtors and others and have implemented their own fraud detection measures, such as reviewing bankruptcy petitions and schedules of assets to identify concealed property. Where no criminal violation occurs or where prosecution for fraud may be unlikely due to U.S. Attorneys' guidelines or the nature of the case, USTs can file civil lawsuits against debtors or others who attempt to defraud or abuse the bankruptcy system. The UST Program has begun to emphasize such civil enforcement actions and has established nationwide initiatives to address two specific types of bankruptcy fraud — use of false identities and false social security numbers, and unscrupulous bankruptcy petition preparers — for either criminal enforcement or civil enforcement. Lastly, to prevent or detect fraud and abuse by bankruptcy trustees themselves, UST offices review trustees' financial reports and also rely on on-site reviews and external audits.

Trustees

The USTs rely on private trustees as the first line of defense in detecting bankruptcy fraud, but trustees do not always have the incentive, time, or initiative to conduct the research necessary to detect fraud. Still, trustees are in a good position to help identify fraud and abuse in the bankruptcy system. For most debtors, the trustee is the only bankruptcy official with whom the debtor will interact during the bankruptcy process.

Also, trustees have access to debtors' petitions and schedules, and can request additional information such as tax returns and bank statements. According to the UST Program, trustees can discover fraud in several ways:

- initial review of property schedules, statements of affairs, and statements of current income and expenses;
- review of records such as financial statements and records, Uniform Commercial Code filings and title searches, insurance records, divorce files, bank loan files, proofs of claim, and tax returns;
- interview of debtor at the Section 341 meeting of creditors; and
- complaints or tips from third parties.

To evaluate trustees' performance in activities that could help identify fraud, the UST reviews or attends at least one of the trustee's Section 341 meetings of creditors. The result of that evaluation is documented in the UST annual performance evaluations of Chapters 7 and 13 trustees.

We reviewed the latest UST performance evaluations of Chapters 7 and 13 trustees. In 102 of 118 performance evaluations we reviewed, the USTs determined that trustees implemented the procedures that might detect fraud and abuse. However, in 16 instances the USTs found that trustees did not implement the fraud-detection procedures. Specifically, these trustees failed to: adequately investigate the financial affairs of debtors, ask required questions (listed in Appendix 7) at the Section 341 meeting of creditors, or obtain proof of the debtor's social security number. In nearly all cases of substandard performance, the USTs reminded the trustees during the evaluation of the importance of asking the required questions and obtaining the proof of the debtor's social security number. However, a UST immediately suspended one trustee from receiving new cases for failing to adequately investigate the financial affairs of debtors; the trustee was later reinstated once the deficiencies were resolved.

According to one UST, several obstacles limit the role of trustees in preventing and detecting fraud in bankruptcy cases. The UST indicated that trustees do not have an economic incentive to pursue bankruptcy fraud in Chapter 7 cases where no money is returned to creditors. According to the UST Program, historically 95 percent of Chapter 7 cases are cases where no money is returned to creditors. These cases are commonly known as

“no-asset” cases. As stated earlier in this report, Chapter 7 trustees receive \$60 for administering a “no-asset” case. In cases where money is returned to creditors (asset cases), Chapter 7 trustees receive compensation based on a percentage of the funds disbursed to creditors; the percentage varies depending on the size of the estate. The trustees have little financial incentive to spend many hours reviewing “no-asset” cases to detect potential fraud. However, if the trustees elect to perform the review and uncover assets, they would receive additional compensation for administering the case.

The same UST stated that another obstacle is that trustees’ calendars are crowded and a short period of time is allocated for the Section 341 meeting of creditors. Therefore, trustees may not have sufficient time to thoroughly examine the debtors for concealment of assets, false statements, and multiple filings.

Another UST stated that trustees do not always implement controls to detect bankruptcy fraud. The UST stated that the number of complaints, or tips, received from the public indicates a greater level of criminal activity than is being reported by the trustees. The following example illustrates how debtors’ fraudulent behavior may go undetected by trustees administering the cases for many years.

A couple filed 16 bankruptcy petitions in 10 years, from 1990 to 2000, to hinder and delay foreclosure of real property. In addition, the couple used multiple social security numbers not assigned to them, and failed to disclose prior bankruptcy cases to the court. Six of the 16 petitions were filed in violation of a court order barring the couple from further filings for a period of 180 days. The husband filed four Chapter 13 petitions during the period 1990 to 1992 for the purpose of delaying foreclosure of their residence. When the court barred him from further filings for a period of 180 days, his wife filed a Chapter 13 petition, which included the same residential property, again to secure the automatic stay and delay foreclosure. When the case was dismissed with a bar to further filings, she filed two additional Chapter 13 petitions in violation of this order. When the two cases were dismissed with an order that any further filings by the wife would be null and void, the husband filed another Chapter 13 petition including the same residential property. The husband then filed a Chapter 7 petition in which he obtained a discharge of his debts in 1998. The most recent case was filed in January 2000, at which time the same Chapter 13 trustee was administering the case and the two previous cases filed by the couple.

Although there is no stipulation in the law as to how many times a debtor can file for bankruptcy without a discharge, filing for bankruptcy in an attempt to defraud creditors is a violation of the Code. Action was not taken against the couple until a secured creditor stated in a motion for relief from the automatic stay that the filing was the 13th filing and that creditors were forced to cancel and resume foreclosure proceedings 11 different times. After reviewing the motion for relief, the Chapter 13 trustee referred the case to the UST. The UST reviewed on-line public credit records and found that the couple used multiple social security numbers and various aliases to file for bankruptcy relief and obtain credit. The UST then referred the case for potential criminal prosecution. The UST Program contracts with a company to provide access to on-line public information. As of the third quarter of FY 2002, the UST Program spent about \$122,000 for the on-line service contract. Every UST office has access to the database by a dial-up line. The UST offices use the on-line service to identify and locate concealed assets, verify social security numbers, and obtain litigation history information after receiving an allegation of fraud. In our judgment, the on-line service also would be effective in detecting debtor fraud if USTs routinely used it in the course of reviewing bankruptcy petitions.

Tips

The AUSTs at the five regional offices we audited stated that they rely substantially on complaints, or tips¹⁵ from the public — usually an ex-spouse or ex-business partner — to report instances of bankruptcy fraud. Because UST Program data did not indicate what percentage of UST referrals to law enforcement authorities were based on tips, we reviewed the fraud referrals made in FYs 1999 to 2001. We reviewed all of the referrals made during the three years, except in the Los Angeles Regional Office where we sampled because of the volume of referrals.¹⁶ In total, our sample included 302 referrals for the five regional offices.¹⁷ We reviewed the case files for each fraud referral to determine the method of detection. The table below shows that most of the criminal referrals (48 percent) resulted from tips by creditors, ex-spouses, ex-partners, and victims. The method of detection for the 302 referrals to law enforcement authorities is detailed in the following table.

¹⁵ The Program does not provide rewards or other financial incentives for tips that lead to prosecution or civil enforcement.

¹⁶ The Los Angeles Regional Office made 865 referrals during the three years; we judgmentally selected 10 percent (86) of the 865 cases.

¹⁷ According to the EOUST, USTs are not always made aware of the outcome of fraud referrals. Therefore, complete data on prosecutions is not available for the 302 referrals.

Method of Detection in Sampled Cases Tips vs. Other Methods						
Method	NY	PHL	CHG	LA	ATL	Total
Tips	23	24	18	44	36	145
Review of debtor's financial records	7	3	21	32	20	83
Unable to determine	8	9	1	3	11	32
Section 341 meeting of creditors	7	3	4	4	11	29
Reverse referrals	0	0	5	3	0	8
Judicial proceeding	3	2	0	0	0	5
Total	48	41	49	86	78	302

Source: Field offices' case files

- Referrals for 145 of 302 sampled cases were made based on tips received by either the UST or the trustee from individuals outside of the Department such as creditors and victims of the fraud. The subjects of the referrals were debtors, debtor's principals,¹⁸ and private attorneys. The types of frauds allegedly committed by these individuals included bribery, concealment of assets, consumer fraud, equity skimming, counterfeiting, false identity, false statements or documents, embezzlement, forgery, and multiple filings.
- Eighty-three referrals were based on reviews of debtors' financial records; 69 by trustees, 6 by USTs, and the remaining 8 by professionals hired by trustees and creditors. The subjects of the referrals were debtors and petition preparers. The type of alleged fraud committed by these individuals included concealment of assets, false identity, consumer fraud, false statements or documents, embezzlement, serial filers, and rigged auction.
- Thirty-two referrals either did not have a case file or the method of detection was not stated in the file. Case files were not available

¹⁸ Debtor's principals are officers of entities that filed for bankruptcy protection.

because either the referrals were made verbally or were destroyed after the U.S. Attorneys declined the cases. According to the UST Program's fraud referral database (discussed in Finding 2), the subjects of the referrals were debtors, private attorneys, and petition preparers. The types of suspected fraud included false identity, concealment of assets, embezzlement, arson, false statements or documents, and forgery.

- Twenty-nine referrals were based on the Section 341 meeting of creditors. The subjects of the criminal referrals were debtors and debtors' attorneys. The type of fraud allegedly committed by these individuals included concealment of assets, equity skimming, false identity, false statements or documents, forgery, and embezzlement.
- Eight referrals were from the U.S. Attorney or the FBI to the UST for initial investigation of suspected debtor fraud such as concealment of assets and false identity.
- Five referrals were based on judicial proceedings such as adversary proceedings, a rule 2004 examination,¹⁹ and a court hearing. The subjects of the referrals were debtors and debtor's principals who allegedly committed fraud through bid rigging, concealment, and false statements or documents.

Tips from outside sources are one useful tool in combating bankruptcy fraud; however, tips are a passive method and are not a substitute for effective management controls to prevent and detect the most significant bankruptcy problems and to target resources accordingly. Further, not all tips are legitimate, yet the information provided requires time and effort to investigate. The amount of resources the UST Program devotes to these cases is unknown since field offices do not track their investigations (see Finding 2).

Civil Enforcement

Civil enforcement action — as well as criminal prosecution — can be an effective tool to help combat bankruptcy fraud. Although criminal prosecution is a strong method for combating bankruptcy fraud, not all fraud referrals result in prosecutions. Therefore, the UST, or another interested

¹⁹ A rule 2004 examination allows trustees or creditors to conduct a more extensive examination of debtors' petitions, schedules and financial documents.

party, may file a civil lawsuit against a debtor or a petition preparer. Unlike a criminal fraud prosecution, civil enforcement actions do not require a criminal investigation or involvement of a U.S. Attorney. Instead, the UST may file a complaint with the court to outline the alleged wrongdoing of the debtor or others after identifying the benefit of the fraud and then selecting the appropriate civil enforcement action to deny that benefit. The most common benefits of fraud include: (1) the automatic stay, which prevents the creditor from pursuing any action against the debtor or the property of the estate to collect or enforce a pre-petition debt; (2) the discharge, which removes the debtors obligation to pay a debt; and (3) creditor inertia, which causes many creditors to write off debt when a bankruptcy case is filed and abandon collection efforts even if the case is subsequently dismissed. A bankruptcy court judge hears the case and issues a court order outlining the findings of the court. The UST Program has made civil enforcement its number one priority.

Among the civil enforcement actions available to USTs are:

- a motion to dismiss a case,
- an objection to the dismissal of a case,
- a motion to deny or revoke a discharge,
- a motion to appoint a trustee or an examiner,
- a motion to convert a case to another chapter,
- a motion to compel a debtor to appear or provide documents,
- a motion for sanctions against a party for failure to adhere to the ruling of the court,
- a complaint for permanent injunction, and
- a recovery of unauthorized expenses or excessive compensation.

In addition the UST may take administrative action to:

- suspend a panel trustee from case assignments, and
- remove a trustee from the panel of trustees.

On October 30, 2001, the then Acting Director of the EOUST announced an initiative intended to more aggressively use existing civil enforcement methods to curb abuse of the bankruptcy system. The Acting Director stated:

[E]ffective case administration is vital to ensure the American public that the bankruptcy system provides relief for honest but unfortunate debtors overcome by serious financial difficulties. The Civil Enforcement Initiative emanates from the U.S. Trustee Program's long-standing commitment to enforce the Nation's bankruptcy laws and explore other meaningful strategies to bolster public confidence in the integrity and effectiveness of the bankruptcy system.

According to the Acting Director, the priorities of the Civil Enforcement Initiative require a concerted effort nationwide to use existing tools in a way that best accomplishes tangible results and improvements for case administration. The priorities of the Civil Enforcement Initiative are to:

- ensure that Chapter 7 is not abused and that Chapter 7 debtors are held accountable;
- protect consumer debtors, creditors, and others who are victimized by those who mislead or misinform debtors, make false representations in connection with a bankruptcy case, or otherwise abuse the bankruptcy process;
- ensure that Chapter 11 debtors proceed with their cases promptly and are informed of and held to account for their obligations under the bankruptcy code; and
- fight fraud and abuse by making criminal referrals and assisting United States Attorneys in criminal prosecutions.

To ensure the success of the initiative, each UST was asked to develop an action plan to identify the highest-priority civil enforcement problems in each office and assess the progress made in addressing the problems. The action plan was to:

- identify and describe each civil enforcement problem;

- describe previous actions taken to address each problem, analyze the effectiveness of such prior actions, and list any measures that quantify the scope of the problem; and
- recite the range of remedies available to address each problem and analyze which actions are most likely to be pursued.

At the time of our audit, all 95 offices had submitted civil enforcement action plans to the EOUST. The five UST regions we audited identified either credit card “bust-out” schemes²⁰ or serial filers as the most common problem in their region to be addressed through civil enforcement actions.

For credit card bust-outs, four of the five regional offices we audited reviewed petitions that had at least \$100,000 in consumer debt and little to no assets. In these cases, the regional offices determined whether the debtors filed a bankruptcy petition in bad faith or concealed assets. Filing a petition in bad faith means the debtor made a significant amount of credit card purchases without the intent and means to repay creditors and then immediately filed bankruptcy. The regional offices or trustees requested those debtors who met the criteria for a credit card bust-out to provide additional financial information such as tax returns, bank statements, and credit card statements to assist with the review of the debtor’s financial background. One of the five regional offices did not implement credit card bust-out procedures because it did not consider credit card bust-outs to be a significant problem in that region.

Serial filers are individuals who repeatedly file bankruptcy to gain the benefit of an automatic stay²¹ or a discharge of debts. Serial filers usually do not disclose that they have previously filed for bankruptcy. Some, but not all, UST regional offices use the UST Program’s Automated Case Management System (ACMS) to determine if debtors have multiple filings. The ACMS generates a daily exception report that identifies social security numbers that have been used in more than one bankruptcy filing. In one region, for example, an attorney reviews the exception report to determine if a debtor has received a discharge within the past six years or has been barred from refiling a bankruptcy petition. The attorney notifies the case

²⁰ Credit card bust-outs occur when individuals declare bankruptcy after obtaining goods on credit without the intent to pay and then dispose of the goods for cash.

²¹ Debtors receive an automatic stay when they file for bankruptcy protection. Creditors must cease all collection efforts under the stay unless the bankruptcy court orders a relief from the automatic stay or the case is dismissed.

trustee to obtain additional information from the debtor at the Section 341 meeting of creditors.

The ACMS exception report compares the current filing with at least one previous filing within the same judicial district. This method of detecting serial filers is limited because a comparison is not made nationwide; if a debtor filed for bankruptcy in more than one judicial district, the debtor would not appear on the exception report. For example, a debtor filed two bankruptcy petitions in the Northern District of California and received discharges in April 1989 and June 1992. The debtor then moved to the Northern District of Georgia, filed an additional two bankruptcy petitions, and received discharges in April 1995 and May 1998. According to the Code (11 USC 727), a debtor is barred from receiving more than one discharge in a six-year period. If the ACMS system were enhanced to provide regional offices with the ability to compare bankruptcy filings nationwide, the exception report would be a more effective control for combating serial filers, as long as the regions were required to use the system to help identify serial filers. However, officials in some regional offices suggested that serial filers were not a significant problem in their region.

UST Program officials told us that although they never will be able to prevent or identify all instances of fraud and abuse, civil enforcement has been a successful initiative as evidenced by numerous examples among significant UST events reported weekly to the Attorney General. Subsequent to completion of our audit field work, UST Program officials provided us examples of the reports to the Attorney General. Among the many successful civil enforcement actions reported were:

- Voluntary dismissal of a case in September 2002 prevented discharge of \$1.3 million in debts where debtor had transferred substantially all assets to his spouse or to himself and his spouse as tenants by entirety. The debtor and his non-filing spouse earned over \$180,000 annually, and the spouse owned an estate paid for by the debtor three years before the debtor's bankruptcy filing.
- In August 2002 a debtor converted her Chapter 7 case to Chapter 13 at a hearing on the UST's motion to dismiss the case. The debtor was a single wage earner with no dependents, a \$90,000 income, and a \$215,000 home. Her monthly expenses included: \$2,070 in payments for three notes secured by her house; \$636 for a vehicle; \$411 for telephone, cable, and internet services; and \$340 for furniture. The UST argued that allowing the debtor to maintain her high lifestyle while discharging over \$76,000

in debt would constitute a substantial abuse of the bankruptcy system.

- The Bankruptcy court in July 2002 entered a default judgment denying discharge to a debtor who listed \$1,625 in personal property and \$617,267 in credit card debt on his bankruptcy schedules. The debtor during the Section 341 meeting stated that a former roommate removed over \$60,000 in appliances and furniture without authorization and that he (the debtor) lost over \$100,000 through gambling, used his credit card to cover living expenses for his pregnant wife and four children whom he brought from overseas, for one month visited a discount store almost daily and spent \$62,347, and flew to London and made duty free purchases. An investigator for the discount store disclosed the debtor's scam of purchasing cigarettes for resale through a wholesaler's license allowing tax-free purchases. The former roommate was a producer and wholesaler of food, tobacco, and alcoholic beverages. The UST filed a complaint based on the debtor's false oaths, inability to explain the location of estate property, and failure to keep records.

Debtor Identification Program

The UST Program established a Debtor Identification Pilot Program in 2001 to confirm debtors' identities and social security numbers, ensure a more accurate bankruptcy court record, and assess whether the problems of misidentified debtors and incorrect social security numbers on petitions were widespread. The initiative included efforts to help victims whose credit reports could be affected by the use of incorrect social security numbers on bankruptcy petitions.

The pilot program was based on an identification project begun in September 1999 in Chicago and on similar practices in several other offices nationwide. The Chicago project was expanded to 25 UST offices in 14 regions, covering 18 federal judicial districts, from January 1, 2001 through June 30, 2001.

During the pilot program, all individuals who filed a bankruptcy petition under Chapters 7 or 13 of the Code were required to produce photo identification and confirmation of social security number at the Section 341 meeting of creditors. Acceptable forms of photo identification included:

- driver's license,

- government identification,
- state picture identification,
- student identification,
- U.S. passport,
- military identification, or
- resident alien card.

Acceptable proofs of social security number included:

- social security card,
- medical insurance card,
- pay stub,
- IRS W-2 form,
- IRS Form 1099, or
- Social Security Administration report.

The pilot program included 127,590 Chapter 7 and Chapter 13 cases filed in the 18 federal judicial districts. Of these cases, about 1,225 (one percent) initially had problems with the debtors' identifications or social security numbers. While most of the problems proved to be typographical errors (1,006), some involved questionable names or identity documents (191), and possible misuse or falsification of social security numbers (32).

If the debtor failed to bring the proof of identification or social security number to the meeting or the name or social security number did not match the information on the petition, trustees proceeded with the standard questions at the Section 341 meeting but continued the meeting on another date for production of the required documentation. Trustees referred cases to the UST for appropriate action if debtors failed to provide the documentation or file amended petitions. The UST would then take civil action to dismiss the case, object to bankruptcy discharge, or object to confirmation of a Chapter 13 repayment plan. Instances of possible identity

fraud were referred to the U.S. Attorney for criminal investigation and potential prosecution.

Based on the results of the pilot program, the then Acting Director of the EOUST issued a new rule that required every individual filing a personal bankruptcy case under Chapters 7 or 13 to show proof of identification at the Section 341 meeting. The new requirement began phasing in nationwide in January 2002.

Petition Preparer Program

Some non-attorneys charge debtors a fee for preparing bankruptcy petitions. The UST Program has found that some petition preparers have attempted to provide legal advice and services to debtors but lack the necessary training and experience to provide these services in an adequate and appropriate manner. Other petition preparers have defrauded or charged excessive fees to debtors who are unaware of their rights both inside and outside of the bankruptcy system. UST Program officials said that fees unlawfully taken by petition preparers are usually small, but the victims are destitute, distraught, and vulnerable to fraud schemes. Further, UST Program officials said they have seen a proliferation of bankruptcy petition preparers nationwide, although they have not specifically estimated the extent of the problem. Section 110 of the Code provides the UST Program with a new civil remedy for unscrupulous petition preparers. The Code establishes requirements for petition preparers and penalties for those who negligently or fraudulently prepare bankruptcy petitions. For example, petition preparers must:

- sign the bankruptcy petition and include the preparer's name, address, and social security number;
- furnish a copy of the bankruptcy petition to the debtor;
- not file any document (bankruptcy petition) on behalf of a debtor;
- not use the word "legal" or any similar term in any advertisements, or advertise under any category that includes the word "legal" or any similar term;
- not collect or receive any payment from the debtor or on behalf of the debtor for the court fees in connection with filing the petition; and

- within 10 days after the filing of a petition, file a declaration disclosing any fees charged to the debtor within 12 months prior to the filing of the case (the court will disallow and order the return to the bankruptcy trustee of any fees found to be in excess of the value of the services rendered by a petition preparer).

If a petition preparer violates the above requirements, the court can fine the preparer up to \$500 per violation. For example, if a petition preparer fails to comply with all six requirements in one petition, the preparer can be fined as much as \$3,000.

In FY 2000, the UST Program awarded a \$60,000 contract to develop a database that would track petition preparers nationwide. The database was to perform several functions: (1) monitor petition preparers who are suspected of violating the Code; (2) improve timely and effective enforcement techniques; (3) provide sample pleadings and other court filings; and (4) provide the current status on pending actions. The database is available to the entire UST Program because it is accessible through the UST Program's intranet website. We did not audit the petition preparer tracking system because it was being implemented at the time of our audit. However, it appears that the tracking system should be helpful to the UST Program in monitoring petition preparers.

UST Program Monitoring of Trustees

Part of the UST Program's oversight responsibilities includes establishing controls to ensure that trustees and their employees do not embezzle funds or misappropriate property from the bankruptcy estates entrusted to them. In fact, most of the management controls implemented by the UST Program have been designed to detect fraud committed by trustees and trustees' employees rather than by debtors or others. The controls established by the UST Program to detect fraud committed by trustees and their employees include: (1) review of the semiannual report, which provides information on the Chapter 7 trustee's financial management, internal controls, organizational effort and legal administration of cases administered by the trustee; (2) review of cash receipts and disbursements reports; (3) review of the trustee final report (TFR), which certifies that all assets have been liquidated and are properly accounted for and that funds of the estate are available for distribution; (4) review of the trustee final account (TDR), which certifies that funds have been distributed to creditors; and (5) external audits and UST field examinations.

UST Program officials told us that due to their success in monitoring trustees, they have begun to reallocate resources to civil enforcement

actions against debtor fraud and abuse. The UST's monitoring efforts have resulted in faster administration of Chapter 7 cases. For example, the number of Chapter 7 cases open longer than three years declined from 22,404 in April of 1992 to 5,430 at the end of FY 2001. As a result, the UST Program has streamlined its oversight procedures for Chapter 7 trustees by: (1) reviewing trustees' financial reports annually instead of a semiannually; (2) eliminating the review of the trustee's financial report if scheduled for an OIG audit or UST field examination; and (3) conducting a limited review of trustee final reports in cases where the gross receipts total \$5,000 or less. The additional resources that resulted from the streamlining have been allocated to reviewing bankruptcy petitions for possible civil enforcement actions.

Over the past 15 years (1986 through 2001), the UST Program has made 71 out of 7,564 total referrals to the U.S. Attorneys for embezzlement by trustees or their employees with estimated loss totaling \$18.8 million. These 71 individuals were sentenced and ordered to repay \$6.9 million (37 percent) to the estates. The methods of detection for the 71 referrals were:

- 25 discovered by the UST,
- 16 based on tips,
- 9 discovered by trustees,
- 5 discovered through audits, and
- 16 unknown.

Review of Semiannual Reports

Chapter 7 trustees are accountable for all property of an estate assigned to them, and the trustees are required to report on their administration of the estate. The UST Program established a uniform record-keeping and reporting system so that Chapter 7 trustees can properly perform their duties and effectively administer cases. The system consists of three reports: Individual Estate Property Record and Report (Form 1), Cash Receipts and Disbursements Record (Form 2), and Summary Interim Asset Report (Form 3). These reports were commonly known as the "semiannual report" or the "180 day report" because trustees were required

to submit the report semiannually to the UST.²² Each UST office must review the semiannual reports within 60 days of receipt from a Chapter 7 trustee. The review concentrates on the trustee's: diligence in identifying, pursuing, and recovering assets for the benefit of creditors; timeliness in closing cases; compliance with reporting and other requirements of the UST; and performance of the trustee responsibilities. The UST office is required to document its findings in writing and provide the findings to the trustee for corrective action. Any major problems identified during the review process are to be discussed with the trustee. Trustees who are deficient in their administration of cases can be subject to a wide range of compliance measures by the UST Program or the court.

From the five offices we audited, we judgmentally selected the two most recent semiannual reports for a total of 52 Chapter 7 trustees covering the period January 2001 through December 2001. We found that of the 104 semiannual reports, 94 were reviewed by the UST offices. Five reports were not submitted because the trustees filed a TFR for the only remaining case they administered. According to one UST field office representative, if a TFR is filed for the only remaining case administered, then the semiannual report is not required because the UST will review the TFR. Another five reports were not reviewed because there had been an on-site review or an external audit.²³

USTs reviewed the 94 semiannual reports and reported findings to the trustees for each report. The findings dealt primarily with administrative matters such as incorrect dates, bonding amounts, and reference numbers.²⁴ For 44 of the 94 reports, the regions noted fraud indicators such as failure to secure sale of proceeds from an auctioneer; unauthorized use of a professional; and failure to disclose a petition asset. The regional offices followed up on each of the findings until corrective action was completed; however, the regional offices had not discovered fraud through the semiannual reports we sampled.

We noted during our review that UST regional offices did not always review the semiannual reports timely. USTs are required to review

²² Effective July 1, 2002, Chapter 7 trustees are required to submit these reports annually unless the trustee is newly appointed, suspended from rotation, or the UST has a concern or perceives a problem with the trustee's administration of cases.

²³ According to the UST Manual, USTs are not required to conduct a separate review of the semiannual report for any period that is also the subject of a UST field examination or an OIG audit.

²⁴ Trustees use reference numbers to track assets listed on debtors' schedules.

semiannual reports within 60 days of receipt from the trustee. Timely review can minimize the amount of loss if a trustee or a trustee's employee is engaging in embezzlement or other fraud. Twelve of the 94 reports were reviewed from 1 to 45 days late or an average of 15 days late.

Review of Final Reports and Final Accounts

Chapter 7 trustees are required to prepare and file a TFR with the UST for review before filing it with the court. The TFR certifies that all assets have been liquidated and properly accounted for and that funds of the estate are available for distribution. The TFR must be prepared when all monies have been collected, all claims have been reviewed or determined by the court, and the date has expired for creditors to file claims. Also, the TFR summarizes all actions taken by the trustee to administer the case. The TFR must:

- describe the disposition of each estate asset,
- report all financial transactions by the trustee,
- request payment of the trustee's compensation and expenses and any unpaid professional fees and expenses,
- report the trustee actions on claims or their disposition,
- propose the distribution to creditors bankruptcy code, and
- include the original bank statements and original canceled checks received by the trustee during the case.

USTs are required to conduct a thorough review of each TFR within 60 days of receipt from the trustee to assess whether the trustee has properly and completely administered estate property. The UST is to examine exemptions, abandonments, sales or other liquidations; ensure inclusion of all necessary court orders; and verify the accuracy of calculations. The UST also determines whether the trustee reviewed and properly dealt with all claims. Deficiencies in the trustee's administration or other problems or mistakes are to be brought to the trustee's attention for corrective action. Upon completion of the review, the UST forwards the TFR to the court.

The UST Manual provides a checklist for USTs to use in reviewing TFRs. Each regional office develops its own review procedures to comply with the UST Manual. We compared the review procedures for the five

regional offices we audited to the checklist and found that each of the five regional offices did not implement at least one of the required TFR review procedures. The following table shows the procedures that were not implemented by the regional offices.

Procedures Omitted From the Audited UST Regions' Checklists for the Review of Trustee Final Reports					
Procedure	Region				
	NY	PHL	CHG	LA	ATL
Require original bank statements and canceled checks received by trustee during the case.			X		
Verify that the Section 341 meeting was held and concluded.				X	
Review Schedule D for undisclosed assets that were not listed on the debtor's property schedules.	X		X	X	
Ensure that the amount of money realized for all assets liquidated or turned over are properly recorded on Form 1.	X				
Trace all realizations reported on Form 1 to a corresponding deposit on Form 2.	X				
Ensure that interest earned on estate bank accounts are reflected on Form 1 and Form 2.			X	X	
Review all canceled checks to ensure that the payee, endorsement, and amount match the Form 2 and other applicable documentation.		X	X		
Verify any transfers of estate funds between checking and savings accounts.	X	X	X	X	
Subtract the disbursements from the receipts to determine that the balance on hand, as reported by the trustee in the final report, reconciles with the bank statements from the estate's depositories.		X			X

Source: OIG review of UST regional offices' checklists for TFR reviews

UST regional office officials stated that although the procedures listed above are not included on the TFR review checklists, the analysts are

implementing the procedures. We were not able to verify whether or not analysts carried out all the procedures due to the lack of documentation. These procedures are crucial in identifying fraud indicators within a bankruptcy case. For example, verifying any transfers of estate funds between checking and savings accounts ensures that the funds were transferred to the account stated in the report and not possibly to the trustee's private account. The USTs in the regional offices should include the missing procedures in their review checklists to ensure that all bankruptcy analysts and paralegals are implementing all required procedures. In addition, regional offices implement the review procedures during field examinations and semiannual reviews. However, the procedures are carried out on a sample basis. The review of the final report provides the regional offices with the opportunity to review a case in its entirety and discover any errors or potential fraud that might have been missed during the semiannual report reviews.

USTs are required to review TDRs within 125 days after the entry of an order allowing final compensation and expenses. The trustee must submit to the UST the TDR certifying that the estate has been fully administered. Along with the TDR, the trustee must submit the original bank statement(s) showing a zero balance and all original canceled checks except those already submitted with the TFR. The TDR is to be submitted to the UST, who must review and file the TDR with the court within 30 days of receipt. The UST review is to verify that all disbursements were made in accordance with the trustee's approved TDR. The USTs are to ensure that funds were issued to appropriate parties and for the correct amount.

To assess whether the review of TFRs and TDRs would detect fraud, we judgmentally sampled 150 TFRs and TDRs filed for the period July 2000 to March 2002 within the five regional offices.²⁵ Eighty-four trustees filed the 150 TFRs and TDRs. In the Atlanta and Los Angeles regional offices, the reviewers did not always formally document the review of the TFRs and TDRs. Our review found that only 5 of the 150 reviews identified potential fraud such as unexplained reimbursements, unapproved payment for professional fees, and proposed distributions for unallowed claims. The Philadelphia Regional Office discovered fraud indicators in four of the five TFRs and did not file the TFRs with the court until the trustees took corrective action. However, after investigation, the regional offices did not verify fraud in any of these cases.

²⁵ We selected 25 or 10 percent of the TFRs and TDRs filed, whichever was less, during the period from the five regional offices.

Review of Cash Receipts and Disbursements Reports

The UST Program requires debtors-in-possession²⁶ and trustees for Chapter 11 cases to submit monthly financial reports. According to the UST Manual, these reports are intended to provide the USTs, court, creditors, and other interested parties with reliable information on the current status of a case. The financial reports are filed with both the UST and the clerk of the court. The debtor is also required to provide the financial reports to the chair of any creditor's committee appointed to serve in the case.

The Cash Receipts and Disbursements Statement is one of the financial reports. The statement shows the receipts and disbursements of the debtor, as well as a separate cash account reconciliation statement for each of its bank accounts such as the general account, tax escrow account, and payroll account. The information included in the statement is to be analyzed by the USTs to discover whether:

- the debtor is making unauthorized payments to professionals,
- the debtor is improperly paying pre-petition debtors,
- the debtor has sufficient cash flow to effectively reorganize,
- inordinate payments are being made for travel, entertainment, other employee benefits, and
- improper payments are being made by the debtor that will hamper the ability to reorganize.

To assess the effectiveness of this management control in detecting potential bankruptcy fraud among Chapter 11 trustees and debtors-in-possession, we reviewed 40 cash receipts and disbursements statements submitted to four of the five field offices²⁷ between February 2001 and March 2002. In each field office audited, analysts did not formally document their review of cash receipts and disbursements statements. Also, no documented findings resulted from the reviews in any of the four field offices. According to UST Program representatives from

²⁶ Debtors-in-possession are debtors who are in custody of the estate because the court has not appointed a trustee in the case.

²⁷ The control was not tested at the first location audited, but we added a testing procedure at the subsequent four locations.

each office, cash receipts and disbursements statements are primarily used to calculate monthly fees owed to the UST Program by the bankrupt entity. UST Program personnel also indicated that a more extensive review occurs; however, we were unable to verify the extent of the review. As a result, we were unable to assess the effectiveness of this management control for detecting fraud among the Chapter 11 trustees and debtors-in-possession.

Field Examination and External Audits

Chapter 7 and Chapter 13 trustees are required to receive an audit or a field examination over specified time frames. During an eight-year cycle Chapter 7 trustees must receive at least one audit conducted by the OIG and a field examination by the UST. The scope of the audits and field examinations generally encompasses a review of the trustee's: (1) case reporting; (2) banking and bonding practices; (3) internal controls, including segregation of duties; (4) automated data processing and file maintenance; and (5) accounting for, securing, and administration of assets. Field examinations and audit reports render one of three opinions: (1) adequate; (2) adequate, except for certain deficiencies; or (3) inadequate. If a trustee receives an inadequate opinion from a field examination or an OIG audit, the UST Program will suspend the trustee from active rotation. Suspension from active rotation means that the trustee no longer receives new cases. Reinstatement of the trustee requires the approval of the EOUST Deputy Director. Prior to reinstatement, the trustee must provide evidence that the necessary corrective actions were implemented. The UST reviews the trustee's response and makes an on-site visit to the trustee's office to verify compliance, if necessary.

Each Chapter 13 trustee is required to be audited by an independent accounting firm annually. The audit may be supplemented by a management review performed by the UST at the trustee's office. The objective of the management review is to assess the trustee's performance in specific areas such as case administration, case closing, claims review, and personnel management. Whenever an audit report contains a consequential finding or a series of less consequential findings, the trustee must submit a written statement confirming that the deficiencies have been corrected. Within three months, the UST is to visit the trustee's office to verify compliance.

To assess the effectiveness of this management control, we reviewed the case files for 210 Chapter 7 trustees within the five regional offices and all 186 Chapter 13 trustees within the UST Program. Our review showed that each of the 210 Chapter 7 trustees received a field examination and an

OIG audit from 1994 to 2002. We also found that all 186 Chapter 13 trustees received an independent audit in annually. Therefore, the UST Program has ensured that trustees are audited or reviewed.

In the past 15 years, the USTs made five referrals to the FBI or U.S. Attorneys as a result of external audits. Although the audits focus on trustees' administrative procedures, in a few instances the audits have identified potential fraud.

Conclusions

The USTs rely predominantly on trustees and tips from the public to detect fraud by debtors, creditors, and others. While the UST Program has some basis for viewing trustees as its first line of defense against fraud, trustees may not have the time or inclination to rigorously investigate debtors or others for potential fraud and may only detect the more obvious and flagrant cases. In fact, we found numerous examples of fraud being detected as a result of tips from persons other than the trustees. Although tips are a valuable tool for detecting fraud, if the UST intends for trustees to bear the main responsibility for fraud prevention and detection, the trustees require more definitive guidance and training on the specific steps they are required to take, and time and resources must be made available for that purpose.

Aside from relying on trustees and tips, the UST Program has begun to address directly two nationwide problems – identity theft and unscrupulous bankruptcy petition preparers. However, the extent of controls over other types of fraud varies by region. In general, the UST Program concentrates its efforts on controls over trustees and their employees rather than over some of the higher risks for fraud. Through the deterrence of UST Program monitoring and the integrity of the trustees themselves, only 71 (less than one percent) of the 7,564 referrals made to law enforcement over the past 15 years related to trustees and their employees. Without ignoring the possibility of trustee fraud, the UST Program needs to improve its own efforts to control fraud by debtors, creditors, and others. For example, in August 2001, the FBI stated that serial filings, and concealment of assets were among the serious problems that deserve national investigation. UST Program officials have not established management controls on a national level to address these types of fraud. Also, we noted that local UST Program efforts to control various types of fraud lack uniformity; some regions take more vigorous action on certain types of potential fraud than do others. The UST Program has begun to emphasize civil enforcement actions

as well as referrals to law enforcement agencies where it has identified fraud or abuse. This emphasis, along with the refocusing of resources from less-likely trustee fraud, should contribute to meeting the goal of protecting the integrity of the bankruptcy system.

Recommendations

We recommend the Director, Executive Office for U.S. Trustees:

1. Establish uniform management control procedures within the UST offices to prevent and detect the more common and higher-risk types of fraud affecting the bankruptcy system, such as concealment of assets and serial filers, and ensure that resources are targeted accordingly.
2. Expand the existing data system to allow for detection of multiple bankruptcy filings nationwide.
3. Ensure uniform and complete reviews of Final Reports and Final Accounts.
4. Ensure that review procedures for cash receipts and disbursements reports are fully implemented.

FINDING 2: PERFORMANCE MEASUREMENT SYSTEM

The UST Program's management information system is used to track over 7,500 fraud referrals made to law enforcement authorities between January 1988 and September 2001 and to measure UST Program performance. The information contained in the tracking system was not fully reliable because of: inaccurate, missing, or inconsistent data; lack of standard data protocols; and lack of review by UST Program personnel to ensure the accuracy and completeness of the data. In addition, the tracking system did not cover the UST Program's own efforts to investigate bankruptcy fraud cases, and there was no national system to track civil enforcement actions. As a result, the UST Program was not in a position to conduct complete and accurate trend analyses of fraudulent activity to help target attention to the greatest risks. Also, the Department and the UST Program itself may rely on incomplete and inaccurate data to measure the UST Program's performance and make funding and resource allocation decisions.

Tracking and Reporting Requirements

According to the UST Manual, the EOUST is required to maintain a database to track criminal fraud referrals made by the UST Program to U.S. Attorneys, the FBI, or other law enforcement authorities.²⁸ At the end of each calendar quarter, the EOUST provides each UST with a report detailing the referrals made by the region based on data submitted. The referrals are divided into open and closed categories.

Each region or district office tracks its referrals until the referral is closed through prosecution or a decision by the U.S. Attorney to decline, or not prosecute, the case. The UST region or office is also to submit an updated report to the EOUST each quarter providing information on new referrals and the status of all open referrals, paying particular attention to those that are more than one year old.

According to data from the Criminal Referral Tracking System, the USTs made 7,564 fraud referrals to law enforcement from January 1988 to

²⁸ The UST Program maintains a separate tracking system for criminal fraud referrals because the referral information is confidential, whereas the Automated Case Management System (ACMS) is accessible to all UST Program employees.

September 2001.²⁹ The EOUST uses the tracking system primarily for performance measurement reporting and for internal management reports. Based on the audit results presented later in this finding, the UST Program's data system is materially unreliable. However, we are reporting information from the system as the only available data on fraud referrals, convictions and potential loss. When system data is considered in context with other available evidence, the conclusions in this report are valid.

The 7,564 fraud referrals made between 1988, when tracking began, and September 2001 resulted in 1,038 indictments and 837 convictions, or an overall conviction rate of 11 percent of the referrals. In addition, the UST Program identified about \$11 billion in potential losses.³⁰ The following table shows by regional office the number of referrals, convictions, conviction rates, and potential losses. The table shows considerable variation in the number of referrals, convictions, and conviction rates. Los Angeles had the most referrals at 2,834 and convictions at 164 — although the region's conviction rate was under 6 percent — and Cleveland had the least referrals at 94 with none resulting in a conviction. Cedar Rapids had the highest conviction rate, nearly 34 percent, although it produced only 145 referrals. Fourteen of the 21 regions made referrals that resulted in a conviction rate exceeding the UST Program average. According to unverified data in the tracking system, Denver at a reported \$10 billion accounted for 93 percent of potential losses due to fraud.³¹ However, as discussed in the upcoming section of this report dealing with the tracking system, 72 percent of cases referred for prosecution did not identify the amount of loss.

²⁹ As discussed subsequently in this report, we found that the data system contains errors and omissions. However, we are reporting information from the system because it is the best overall data available on fraud referrals, convictions, and potential losses.

³⁰ Potential losses are estimated by the UST's office after the initial investigation. The FBI agent or the AUSA assigned to the case identifies the actual loss to the estate after further investigation. Also, another source for this entry may be a court order requiring restitution.

³¹ We did not audit the Denver Regional Office and therefore did not verify the \$10 billion figure reported in the tracking system.

UST Program's Data on Referrals, Convictions, and Potential Loss by Regions As of September 2001				
Regional Office	Number of Referrals	Number of Convictions	Conviction Rate	Potential Loss
Boston, MA	410	43	10.49	\$213,679,014
Manhattan, NY	404	46	11.39	\$86,247,200
Philadelphia, PA	386	36	9.33	\$30,960,472
Columbia, SC	278	34	12.23	\$485,032
New Orleans, LA	130	24	18.46	\$32,546,225
Dallas, TX	271	38	14.02	\$11,955,602
Houston, TX	142	16	11.27	\$14,164,478
Memphis, TN	359	47	13.09	\$23,522,526
Cleveland, OH	94	0	0	\$36,910,600
Indianapolis, IN	104	20	19.23	\$4,159,833
Chicago, IL	205	38	18.54	\$3,209,500
Cedar Rapids, IA	145	49	33.79	\$96,040,778
Kansas City, MO	184	36	19.57	\$8,362,554
Phoenix, AZ	135	29	21.48	\$11,554,000
San Diego, CA	185	57	30.81	\$2,571,261
Los Angeles, CA	2,834	164	5.79	\$1,230,000
San Francisco, CA	243	35	14.40	\$38,667,095
Seattle, WA	318	60	18.87	\$17,846,741
Denver, CO	132	13	9.85	\$10,051,356,500
Wichita, KS	159	14	8.81	\$31,883,242
Atlanta, GA	446	38	8.52	\$74,359,829
Total	7,564	837	11.07	\$10,791,712,482

Source: EOUST

Fraud Referrals to Law Enforcement

The UST regional offices are responsible for making fraud referrals to appropriate law enforcement agencies when there is evidence of a crime. The UST regional offices receive allegations of criminal activity from many sources, including third parties (creditors, ex-spouses, or ex-business partners), trustees, judges, and law enforcement agencies. Regional offices prefer to receive allegations in writing but may also accept complaints made orally. Also, regional offices sometimes discover criminal activity based on their review of debtors' bankruptcy petitions, trustees' operations, and petition preparers. Regional offices conduct a preliminary investigation to determine whether an allegation of fraud appears valid. The extent of the investigation varies depending upon the type of potentially criminal activity involved. For example, concealment of assets in bankruptcy proceedings may involve less investigative effort than a complicated ponzi scheme³² to defraud investors. The UST regional offices use a number of tools to aid them in the investigation, such as reviewing on-line investigative public records, verifying information on petitions and schedules with outside agencies such as the Social Security Administration, reviewing court docket information, and photographing concealed physical assets.

If a regional office determines that fraud or another crime may have been committed, it prepares a referral package and forwards the referral to the U.S. Attorney, FBI, or other law enforcement agencies, if needed, for investigation and potential prosecution. The level of detail in the referral package varies by type of case. Also, some regions may not refer cases that do not meet the U.S. Attorney's threshold for prosecution either in terms of dollar amounts or type of offense. For example, an AUST in one region stated that only "good cases" are referred, meaning cases that are likely to be accepted by the U.S. Attorney for prosecution. Other regions opt to refer all cases. Two regional offices apply a three-level priority for referrals. The two offices prepare detailed criminal referral packages for Levels I and II, which are considered high priority because the referrals may meet the U.S. Attorney's minimum prosecutorial guidelines or involve special circumstances such as trustee defalcation, misuse of funds by an attorney or other professional, or other serious violations. Such higher-priority cases are more likely to result in prosecution. The two offices prepare abbreviated packages or a simple form for Level III criminal referrals, which are

³² A ponzi scheme (also known as a pyramid scheme) involves soliciting investments by promising interest rates well above the market rate. Early investors recover their investments with the promised rate of return from funds provided by new investors, and then in turn encourage others to invest. When the scheme collapses before bankruptcy, either a voluntary or involuntary Chapter 7 case is filed.

considered low priority because the referrals do not meet the minimum prosecutorial guidelines or lack strong evidence. Once the packages have been prepared, the fraud referral data is entered into the region's system.

UST Program officials told us that criminal fraud prosecutions have been hampered by a lack of investigative resources, primarily from the FBI. The officials stated that after about a 6-month moratorium on bankruptcy fraud investigations by the FBI in 2001, the UST Program persuaded the FBI to once again investigate fraud referrals. The FBI had agreed to resume fraud investigations, but the events of September 11, 2001 caused the FBI to divert resources to counterterrorism-related efforts. The officials stated that FBI resources for fraud investigations remain limited.

Criminal Referral Tracking System

The EOUST uses the quarterly reports submitted by the regions to update the Criminal Referral Tracking System. The regional offices submit the data on spreadsheets designed by the EOUST. The EOUST performs a limited review of the 21 spreadsheets to ensure that the data fields are properly formatted so the spreadsheets can be downloaded into the EOUST's tracking system. However, the EOUST does not verify that the data is accurate, complete, or consistent. An EOUST staff member stated that the regions are responsible for ensuring the integrity of the data as the regions maintain the supporting documentation.

Our review of the Criminal Referral Tracking System determined that the system is materially unreliable as a result of missing, inconsistent, and inaccurate data and lack of standard data entry protocols. In addition, the tracking system does not include data on the UST Program's efforts to investigate bankruptcy fraud cases prior to referring the case to law enforcement. Although the tracking system provides the only consolidated data available on fraud referrals nationwide, the data in the UST Program's fraud referral tracking system is of limited use due to omissions and errors.

The tracking system contains 33 data fields. Some data fields are more critical than others for UST Program management and performance measurement. The EOUST captures data such as the date of the criminal referral, type of allegation, type of chapter, subject of the referral, type of subject, amount of the potential loss, date of the indictment, date of the conviction, and the statute of limitations. A complete listing of the 33 data fields is included in Appendix 8.

Our review identified missing and inconsistent data for 19 of the 33 data fields in the tracking system, including fields that are vital to managing the UST Program and measuring performance such as the type of fraud, the classification of person committing the alleged fraud, indictments and convictions, and the amount of loss due to fraud. Because of these weaknesses in the data, the tracking system is not as effective a management tool as it could be with more reliable data. Appendix 9 provides a complete listing of the data problems we found. Examples of the problems follow.

- Regional offices used over 2,000 descriptions to identify the type of fraud. The EOUST did not have a standard data entry protocol for the data field and therefore the regional offices used numerous descriptions to identify fraud allegations. The regional offices used U.S. Code citations, narrative descriptions, acronyms, and abbreviations to describe the allegation. For example, the database contained numerous descriptions for concealment of assets such as concealment asset; conceal property; concealment; CA; C; conceal transfer; and 152 (fraud/concealment).
- For 3,465 cases (46 percent), a subject code was not entered. The subject code identifies the classification of the individual who is the subject of the referral such as debtor, creditor, debtor attorney, or trustee. This information is needed to determine the type of individuals committing bankruptcy fraud.
- For 321 cases³³ out of 1,038, an indictment code was not entered. The indictment code identifies the offense(s) for which a defendant is indicted. For these cases, the regions only included the date of the indictment and not the code for the specific offense. The indictment code is an important data field because it is required for reporting the outcome of the referral. In those cases where indictment information was included, the regions used 238 descriptions. The regions entered the number of offenses, the U.S. Code citation, a narrative description, or some variation of the three to identify the indictment code. There was no consistency with the way the data was reported.

³³ This number represents four percent, but not all cases result in an indictment.

- For 276 cases³⁴ out of 837, a conviction code was not entered into the system. The conviction code identifies the offense(s) for which a defendant is convicted. The regions included the date of the conviction but not a conviction code for these cases. The conviction code is an important data field because it is also required for reporting the outcome of the referral. In addition, there were 305 different conviction descriptions included in the tracking system. As with the indictment code, the regions entered the number of offenses, the U.S. Code citation, a narrative description, or some variation of the three to identify the conviction code. Again, there was no consistency with the way the data was reported.
- For 5,472 cases (72 percent), losses due to fraud were not identified. Although in some instances the regional offices may not be able to determine the loss, such information is important to include in the referral whenever possible because some U.S. Attorneys have established prosecutorial guidelines including a dollar loss threshold for bankruptcy fraud cases. For example, an Assistant U.S. Attorney stated that her office does not prosecute bankruptcy fraud cases that do not have a minimum of \$50,000 in losses unless the case involves a high profile fraud with multiple victims. Because the responsible UST is aware of the prosecutorial guidelines, it makes every effort to identify the amount of loss in its criminal referrals. Specifically, this particular regional office identified the amount of loss in 69.5 percent of the cases it referred to law enforcement. In contrast, another regional office with a large number of fraud referrals rarely identified the loss amount. This regional office has a policy of identifying the amount of loss only if obtained from an outside source. However, the Assistant U.S. Attorney stated that her office has established a dollar loss threshold for prosecuting bankruptcy fraud cases but has not disclosed the threshold to the UST regional office.
- For 7,554 cases (99 percent), the date for the statute of limitations was not entered. None of the 21 regional offices always included the statute of limitations for these cases. The statute of limitations for most bankruptcy-related offenses is five years starting from the date the crime is committed, with the exception of concealment of assets. Concealment of assets is a continuing offense, and the five-year statute does not begin until the debtor receives a

³⁴ This number represents nearly four percent, but not all cases result in an indictment and a conviction.

discharge of his or her debts or a discharge is denied. The regional offices need to be aware of the statute of limitations for the cases referred so that the cases can be properly closed. But more importantly, the regional offices need to be aware of the statute of limitations to follow up with the U.S. Attorneys when the date is approaching, especially for those cases that are of particular interest to regional offices.

- For 1,172 cases (15 percent), the subject's name for the referral was not entered into the system. We found that 17 of the 21 regional offices failed to include the subject's name. Again, we are aware that in some instances the identity of the subject may be unknown, especially in identity theft cases. However, if the information is available it should be included in the tracking system because failure to disclose the name could result in duplicate referrals.
- For 1,839 cases (24 percent), the bankruptcy chapter filed by the debtor was not entered into the system. We found that none of the 21 regional offices always identified the chapter for these cases. This information is readily available to regional personnel through the UST Program's ACMS or the bankruptcy courts.

These problems occurred mainly because the EOUST did not establish protocols for entering the data into the tracking system and did not monitor the quality of the data submitted by the regional offices. The regional offices independently determine the type of information that should or should not be included in the data fields. Therefore, the referral data was inconsistent. Also, the regional offices did not make a distinction if information not included was missing or unknown. As a result of the weaknesses in the tracking system, the UST Program is hampered in its ability to follow up on referrals, to perform meaningful trend analyses of fraudulent activity to ensure that resources are focused on the most serious and prevalent fraud and abuse problems, and to accurately measure UST Program performance.

UST Program officials have stated that no one within the bankruptcy community has a true sense of how pervasive fraud is within the bankruptcy system. The UST Program is in the best position to provide accurate data on the extent of detected bankruptcy fraud because most allegations are identified by or reported through the 95 UST Program offices. However, due to the limitations of its tracking system, the UST Program does not currently have complete and reliable data on the fraud identified in the bankruptcy system.

UST Program officials are aware of the limitations of the tracking system and acknowledge the need for improvements. These officials stated that their goal is to ensure that all referrals are accurate, properly researched and supported, and lead to prosecution and conviction. The officials stated that in reviewing the data system they determined that some data fields are not useful for program management or performance measurement. Consequently the UST Program plans to revamp and streamline the data system. Further, the officials pointed out that they must rely on the U.S. Attorney's offices or the courts to provide key data on the results of the referrals. Subsequent to the completion of our audit fieldwork, the UST Program began taking a number of actions to improve its data system, including issuing protocols to the field offices and placing the system under the supervision of a Chief Information Officer.

Regional Offices' Referral Data

Each quarter the regional offices send data on their fraud referrals to the EOUST so that the data can be downloaded into the Criminal Referral Tracking System. To determine the accuracy of the data submitted by the regional offices, we judgmentally selected a sample of referrals made by the five regional offices from FY 1999 through 2001. As stated in Finding 1, our sample size totaled 302 referrals made by the five regional offices. Where possible, we reviewed the case file for each of the 302 referrals. The case files varied widely in size depending on the nature of the allegation and the complexity of the investigation.

Our review of the supporting documentation for the 302 fraud referrals at the regional level found that in 102 of 302 cases (nearly 34 percent) at least one data field was inaccurately completed. We could not verify data for another 27 cases (about 9 percent) due to missing case files. The following table shows the result of our review by region.

**Accuracy of the Fraud Referral Data
FYs 1999 to 2001**

Region	Accurate Data	Inaccurate or Incomplete Data	No Case Files	Total
New York	24	20	4	48
Philadelphia	21	17	3	41
Chicago	22	12	15	49
Los Angeles	56	26	4	86
Atlanta	50	27	1	78
Total	173	102	27	302

Source: Case files maintained at the five field offices audited.

The five regional offices entered erroneous data or failed to enter required data for 102 referral cases. For example, in a few cases the regions entered the debtor as the subject of the referral when in fact the supporting documentation showed that the subject was a petition preparer, an attorney, or the individual could not be identified. In another example, the regional office determined that a debtor illegally transferred and concealed estate property, which resulted in a \$1.5 million loss. However, the region did not include in the tracking system the name of the subject, the amount of loss, or the type of fraud.

Referral data was inaccurate primarily because regional offices did not review the data to ensure its accuracy prior to submission to the EOUST. In one regional office the tracking system is maintained on the region's shared computer drive. Each of the five field offices within the region is responsible for entering its own criminal referral data into the spreadsheet. No one at the regional level is assigned to review criminal referral data to ensure that it is accurate and consistent prior to submitting the data to the EOUST. Although the specific data elements may vary in importance, the fact that some elements are inaccurate or missing undermines the reliability of the UST Program's overall fraud referral tracking system as discussed previously in the section of this report on the national tracking system. The UST Program may not be able to determine the extent of known fraud in the bankruptcy system without ensuring a reliable tracking and management system; reviews of the referral data by regional offices would help ensure the data is accurate and complete.

Data on Bankruptcy Fraud Investigations

As discussed previously, the Code (28 USC 586, 18 USC 3057, and 11 USC 1106) requires UST Program personnel to refer allegations of bankruptcy fraud to law enforcement authorities. Depending upon the region, the investigations are either conducted by field office or regional office personnel. In one of the regional offices we audited, a separate unit (Fraud Unit) was established to centrally manage bankruptcy fraud. The unit was responsible for:

- reviewing all new complaints of criminal activity;
- entering complaints into the region's database tracking system;
- investigating complaints for possible referral to law enforcement; and
- preparing referrals, if needed.

The usefulness of the Criminal Referral Tracking System is limited because it does not demonstrate the extent and success of the UST Program's direct efforts to detect and investigate bankruptcy fraud. The EOUST designed the system to track only those cases that have been referred to law enforcement authorities. The EOUST did not design the tracking system to capture data on investigations conducted by UST Program personnel, nor did it require that regional offices track this data. We found that four of the five regional offices we audited did not track the investigations they conducted unless a referral was made to law enforcement authorities. Also, these offices did not always maintain files for the cases that were investigated but not referred to law enforcement. The files were usually destroyed because the regional offices did not see a need for the information and wanted to conserve storage space. As a result, these offices could not document the extent of their efforts to investigate bankruptcy fraud.

Tracking UST investigations and outcomes could aid the UST Program in allocating resources. The resources needed to conduct the investigations can be extensive depending on the complexity of the case. For example, a case involving a stolen social security number, which most regional offices have encountered, would typically take about two weeks to investigate. However, a complex ponzi scheme would require about six months. One UST stated that resources required to investigate such cases are not taken into account for budgeting and staffing needs for regional offices. The

current budget model is based on the number of bankruptcy cases that are assigned to the regions.

The UST Program was aware that it did not have an accurate measure of its efforts to investigate and detect bankruptcy fraud. In October 2001, the EOUST required that regional offices track the number of criminal investigations that were initiated, including those that did not result in a referral to law enforcement. The request was made as part of the EOUST's Significant Accomplishment Report³⁵ for the period covering October 1, 2001 through March 30, 2002. The Significant Accomplishment Report identifies the UST Program's efforts in civil enforcement, criminal fraud referrals, and other significant legal issues. The report, issued in May 2002, showed that the UST Program had initiated 961 criminal investigations during the semiannual period and that 550 (57 percent) investigations resulted in a referral to law enforcement. Tracking the criminal investigations would be useful to the UST Program for measuring its efforts to investigate and detect fraud, and the Criminal Referral Tracking System could be modified to include both investigations and referrals to avoid duplication of effort and to help ensure data accuracy.

In an effort to enhance its anti-fraud efforts, the UST Program's FY 2002 budget allocated \$1 million to establish a Bankruptcy Fraud Team serving the 11 judicial circuits plus the Washington, D.C. area. The team is to consist of 12 attorneys who are responsible for identifying bankruptcy fraud and supporting the prosecutorial efforts of federal law enforcement authorities. According to the former Acting Deputy Director, one attorney position would be assigned to Washington, and the remaining 11 positions would be assigned to regional offices. He stated that a decision had not been made on allocating the 11 positions among the UST regions. As of May 2002, the positions had not been filled. A more comprehensive and accurate tracking system would have helped provide a basis for allocating these additional resources.

Lastly, although the UST Program has begun to emphasize civil enforcement actions as an alternative or as a supplement to criminal fraud referrals, there is no nationwide system to track such actions or to compile performance data. Instead, the regions have developed their own civil enforcement tracking systems. Some regions have established multiple systems for the various types of civil enforcement actions taken.

³⁵ Each regional office is required to submit a quarterly Significant Accomplishment Report to the EOUST, which is intended to highlight the Program's achievements.

Use of the Data for Performance Measurement

The UST Program prepared a Performance Plan for FY 2002 and FY 2003, and incorporated the plan into its budget submission. The UST Program established a performance goal to ensure that parties adhere to the standards of the law and to police for embezzlement, fraud, and other abuses. To meet the performance goal, the UST Program developed several performance indicators. The performance indicators for FY 2002 and FY 2003 are shown in the following table.

FY 2002 and 2003 Performance Indicators		
Performance Indicator	FY 2002 Target	FY 2003 Target
Number of criminal referrals	No Target	No Target
Number of convictions	No Target	No Target
Number of non-panel trustees administering cases	Not Measured	385
Percentage of motions per Section 707 granted by the Bankruptcy Court, cases dismissed ^{a/}	Not Measured	60 percent
Percentage of motions per 707 that resulted in conversions	Not Measured	60 percent
Percentage of inquiries pursued per Section 707 that results in withdrawal, conversion, or revision that brings the debtor into compliance with court requirements	Not Measured	60 percent
Percentage of complaints to deny discharge per Section 727 granted by the Bankruptcy Court ^{b/}	Not Measured	60 percent
Percentage of inquiries pursued per Section 727 that brings the debtor into compliance with court requirements	Not Measured	60 percent
Percentage of enforcement actions pursued per Section 110 that resulted in withdrawal, stipulation, order to show cause, or sanctions ^{c/}	Not Measured	60 percent
Percentage of inquiries pursued per Section 110 that resulted in voluntary compliance	Not Measured	60 percent

Source: FY 2002 and 2003 USTP Budget Request

Notes:

^{a/}Section 707 (a) of Title 11 addresses dismissal of bankruptcy cases if debtors cause unreasonable delays that are detrimental to creditors, fail to pay bankruptcy filing fees or charges, or fail to file required documentation requested by trustees or USTs. Section 707 (b) includes substantial abuse of the bankruptcy system, e.g. the debtor's debts are primarily consumer debts and the debtor has an ability to repay.

^{b/}Section 727 of Title 11 allows trustees, creditors, and the USTs to object to the discharge if debtors failed to comply with bankruptcy code such as concealing assets, making false statements, or making false claims.

^{c/}Section 110 of Title 11 addresses penalties for non-attorneys who negligently and fraudulently prepare bankruptcy petitions.

In accordance with the Department's overall policy, the UST Program did not establish targets for the number of criminal referrals and convictions but instead reported data on a prior-year basis. The Department issued a policy letter in February 1999 stating that numerical targets would not be established for performance indicators relating to law enforcement activities such as arrests, indictments, convictions, and seizures. The Department created this policy out of concern that such targets could be seen as "bounty hunting." However, the policy does allow components to collect and report on these law enforcement activities on a prior-year basis. The FY 2003 performance plan showed that in FY 2001, the UST Program made 586 referrals to law enforcement and 45 referrals resulted in a conviction. However, the referral data is extracted from the Criminal Referral Tracking System maintained by the EOUST, which we have found materially unreliable due to missing, inaccurate, and inconsistent data. As a result, Congress, the UST Program, and other decision-makers may rely on inaccurate and incomplete data to measure the UST Program's performance and to make funding decisions.

Conclusions

The data on fraud referrals and outcomes in the EOUST's Criminal Referral Tracking System is not fully reliable due to inaccurate, incomplete, and inconsistent data entry and a lack of monitoring by the EOUST and the regional offices. Further, the system lacks standard protocols for entering data, and the data is not adequately verified before submission. The weaknesses in the data system casts doubt on the ability of the UST Program and others to accurately measure the UST Program's performance. The system's limitations also affect the UST Program's ability to analyze trends in fraud and allocate resources accordingly.

Recommendations

We recommend the Director, Executive Office for U.S. Trustees:

5. Redesign the Criminal Referral Tracking System so that it tracks UST investigations as well as referrals made to law enforcement authorities and use the system for trend analyses of the types of fraud and caseloads both nationally and regionally.
6. Establish data entry protocols for the Criminal Referral Tracking System to ensure that the data is complete and consistent.
7. Require regional offices to verify criminal fraud referral data for

accuracy, completeness, and consistency prior to submitting the data to the EOUST.

8. Require the EOUST's staff to spot check fraud referral data submitted by the regional offices to help ensure completeness, uniformity, and accuracy.
9. Establish a system or modify an existing system to accurately track civil enforcement actions nationally and to compile performance data on the civil enforcement aspect of the UST Program.

APPENDIX 1

OBJECTIVES, SCOPE, AND METHODOLOGY

Objectives

The objectives of the audit were to:

- assess the management controls implemented in UST offices to identify and eliminate fraud and misconduct by private trustees, debtors, and others; and
- assess compliance with the Government Performance and Results Act as it relates to bankruptcy fraud.

Scope and Methodology

The audit was performed in accordance with Government Auditing Standards issued by the Comptroller General of the United States, and included tests and procedures necessary to accomplish the objectives. However, the UST Program has reimbursed us for auditing Chapter 7 trustees. Nonetheless, we consider ourselves to be independent and do not believe that our reimbursement arrangements with the UST Program have impaired this audit.³⁶

Generally, the audit focused on the UST Program's efforts to detect and prevent fraud and abuse in bankruptcy cases from September 1988 through May 2002. We performed audit fieldwork at the EOUST in Washington and at UST regional offices in Atlanta, Chicago, Los Angeles, New York, and Philadelphia. These five regional offices were selected because they collectively made up the majority (56 percent) of the reported referrals to law enforcement and provided a cross section of the UST Program's bankruptcy fraud and abuse control procedures and practices.

To accomplish the audit objectives, we performed the following tasks:

- reviewed applicable laws, UST Program policies, procedures, organization charts, and mission statements;

³⁶ The amount of reimbursement for 166 audits in FY 2002 was \$1,293,000.

- reviewed prior audit reports and studies by the Department and the General Accounting Office on related issues;
- reviewed budgetary and contracting documents;
- interviewed the EOUST's personnel in the Director's Office, Office of Review and Oversight, Office of Research and Planning, and Office of Administration;
- interviewed 40 UST Program personnel in the five regional offices including: USTs, AUSTs, Bankruptcy Analysts, Trial Attorneys, Paralegals, Regional Bankruptcy Analysts, and Fraud Coordinators. We also interviewed six non-UST Program personnel including Assistant U. S. Attorneys, a Special Assistant to a U.S. Attorney, FBI Special Agents, and a Postal Inspector.
- reviewed pending bankruptcy legislation;
- reviewed the National Criminal Referral Tracking System, the Trustee and Employee Embezzlement database, the Pending Inquiries of Trustees and Employees of Trustees database, and the Section 110 Tracking System;
- reviewed case file information for 302 criminal referrals;
- reviewed 117 performance evaluations for 97 Chapter 7 and 20 Chapter 13 trustees;
- reviewed supporting documentation for 104 semiannual report reviews;
- reviewed supporting documentation for 92 Trustee Final Reports (TFRs) and 61 Trustee Distribution Reports (TDRs);
- reviewed supporting documentation for monthly operating reports;
- reviewed 24 prior OIG audit reports, 14 independent audit reports, and 15 UST field examinations; and
- reviewed training documentation for trustees and UST Program personnel.

We reviewed the UST Program's management controls over fraud and abuse in the bankruptcy system but did not independently attempt to identify cases of fraud. We did not evaluate the regional offices' civil enforcement action plans, nor did we interview private trustees.

APPENDIX 2

ABBREVIATIONS

ACMS	Automated Case Management System
AUST	Assistant United States Trustee
EOUST	Executive Office for United States Trustees
FBI	Federal Bureau of Investigation
IRS	Internal Revenue Service
MPS	Management and Planning Staff
OIG	Office of the Inspector General
TDR	Trustee Distribution Report
TFR	Trustee Final Report
USC	United States Code
UST	United States Trustee

APPENDIX 3

STATEMENT ON COMPLIANCE WITH LAWS AND REGULATIONS

We have audited the UST Program's management controls over bankruptcy fraud. The audit was conducted in accordance with Government Auditing Standards.

As required by the standards, we tested selected records and documentation to obtain reasonable assurance about the UST Program's compliance with laws and regulations that, if not complied with, we believe could have a material effect on the process. Compliance with laws and regulations applicable to the bankruptcy fraud process is the responsibility of the UST Program's management.

Our audit included examining, on a test basis, evidence about laws and regulations. Specifically, we conducted our tests against the relevant portions of:

Title 28 of United States Code, Section 586

- requires USTs to notify the United States Attorney of matters, which may constitute a crime under the laws of the United States and, upon request, assist the United States Attorney in carrying out prosecutions.

Title 18 of United States Code, Section 3057

- directs private trustees to report suspected violations of federal criminal law to the United States Attorney.

OMB Circular A-11, Part 2

- covers the preparation and submission of budget Strategic Plans, Annual Performance Plans, and Annual Program Performance Reports.

The Government Performance and Results Act of 1993

- directs agencies to develop multiyear strategic plans, annual performance plans, and annual performance reports.

Except for those issues cited in the Findings and Recommendations section of the report, our tests indicated that for those items reviewed, the UST Program complied with the laws and regulations referred to above. With respect to those items not tested, nothing came to our attention that caused us to believe that the UST Program's management did not comply with the laws and regulations cited above.

APPENDIX 4

**UNITED STATES TRUSTEE PROGRAM
REGIONAL AND FIELD OFFICE LOCATIONS**

Region	Regional Office Location	Field Office Location
1	Boston, MA	1 Portland, ME
		2 Worcester, MA
		3 Manchester, NH
		4 Providence, RI
		5 Boston, MA
2	Manhattan, NY	6 New Haven, CT
		7 Manhattan, NY
		8 Albany, NY
		9 Buffalo, NY
		10 Central Islip, NY
		11 Rochester, NY
		12 Utica, NY
3	Philadelphia, PA	13 Wilmington, DE
		14 Newark, NJ
		15 Philadelphia, PA
		16 Harrisburg, PA
		17 Pittsburgh, PA
4	Columbia, SC	18 Baltimore, MD
		19 Greenbelt, MD
		20 Columbia, SC
		21 Alexandria, VA
		22 Norfolk, VA
		23 Richmond, VA
		24 Roanoke, VA
		25 Charleston, WV
5	New Orleans, LA	26 New Orleans, LA
		27 Shreveport, LA
		28 Jackson, MS
6	Dallas, TX	29 Dallas, TX
		30 Tyler, TX
7	Houston, TX	31 Houston, TX
		32 Austin, TX
		33 San Antonio, TX
		34 Corpus Christi, TX

Region	Regional Office Location	Field Office Location
8	Memphis, TN	35 Lexington, KY
		36 Louisville, KY
		37 Memphis, TN
		38 Chattanooga, TN
		39 Nashville, TN
9	Cleveland, OH	40 Detroit, MI
		41 Grand Rapids, MI
		42 Cleveland, OH
		43 Cincinnati, OH
		44 Columbus, OH
10	Indianapolis, IN	45 Peoria, IL
		46 Indianapolis, IN
		47 South Bend, IN
11	Chicago, IL	48 Chicago, IL
		49 Madison, WI
		50 Milwaukee, WI
12	Cedar Rapids, IA	51 Cedar Rapids, IA
		52 Des Moines, IA
		53 Minneapolis, MN
		54 Sioux Falls, SD
13	Kansas City, MO	55 Little Rock, AR
		56 Kansas City, MO
		57 St. Louis, MO
		58 Omaha, NE
14	Phoenix, AZ	59 Phoenix, AZ
15	San Diego, CA	60 San Diego, CA
		61 Honolulu, HI
16	Los Angeles, CA	62 Los Angeles, CA
		63 Santa Ana, CA
		64 Riverside, CA
		65 Woodland Hills, CA
		66 Santa Barbara, CA
17	San Francisco, CA	67 San Francisco, CA
		68 Oakland, CA
		69 Fresno, CA
		70 Sacramento, CA
		71 San Jose, CA
		72 Las Vegas, NV
		73 Reno, NV

Region	Regional Office Location	Field Office Location
18	Seattle, WA	74 Anchorage, AK
		75 Boise, ID
		76 Great Falls, MT
		77 Eugene, OR
		78 Portland, OR
		79 Seattle, WA
		80 Spokane, WA
19	Denver, CO	81 Denver, CO
		82 Salt Lake City, UT
		83 Cheyenne, WY
20	Wichita, KS	84 Wichita, KS
		85 Albuquerque, NM
		86 Oklahoma City, OK
		87 Tulsa, OK
21	Atlanta, GA	88 Miami, FL
		89 Orlando, FL
		90 Tallahassee, FL
		91 Tampa, FL
		92 Atlanta, GA
		93 Macon, GA
		94 Savannah, GA
		95 San Juan, PR

APPENDIX 5

NATIONAL BANKRUPTCY TRAINING INSTITUTE UST PROGRAM PERSONNEL FRAUD TRAINING MAY 2000 TO FEBRUARY 2002

Region	Job Title	Eligible Employees	Employees Attended Training	Remaining Employees
1	AUST	5	3	2
1	Attorney	5	5	0
1	Paralegal Spec.	10	3	7
1	Bankruptcy Analyst	7	1	6
2	AUST	9	6	3
2	Attorney	15	13	2
2	Paralegal Spec.	15	1	14
2	Bankruptcy Analyst	18	6	12
3	AUST	6	3	3
3	Attorney	21	17	4
3	Paralegal Spec.	15	6	9
3	Bankruptcy Analyst	15	7	8
4	AUST	9	8	1
4	Attorney	13	10	3
4	Paralegal Spec.	19	9	10
4	Bankruptcy Analyst	15	7	8
5	AUST	4	2	2
5	Attorney	4	3	1
5	Paralegal Spec.	5	2	3
5	Bankruptcy Analyst	7	2	5
6	AUST	3	1	2
6	Attorney	5	4	1
6	Paralegal Spec.	3	2	1
6	Bankruptcy Analyst	8	4	4

Region	Job Title	Eligible Employees	Employees Attended Training	Remaining Employees
7	AUST	5	3	2
7	Attorney	6	6	0
7	Paralegal Spec.	8	3	5
7	Bankruptcy Analyst	4	3	1
8	AUST	6	4	2
8	Attorney	9	9	0
8	Paralegal Spec.	11	6	5
8	Bankruptcy Analyst	7	6	1
9	AUST	6	6	0
9	Attorney	12	9	3
9	Paralegal Spec.	14	9	5
9	Bankruptcy Analyst	12	5	7
10	AUST	3	3	0
10	Attorney	7	7	0
10	Paralegal Spec.	7	3	4
10	Bankruptcy Analyst	8	5	3
11	AUST	5	4	1
11	Attorney	7	6	1
11	Paralegal Spec.	9	4	5
11	Bankruptcy Analyst	5	5	0
12	AUST	5	4	1
12	Attorney	3	1	2
12	Paralegal Spec.	6	1	5
12	Bankruptcy Analyst	6	3	3
13	AUST	5	3	2
13	Attorney	6	5	1
13	Paralegal Spec.	6	3	3
13	Bankruptcy Analyst	5	3	2

Region	Job Title	Eligible Employees	Employees Attended Training	Remaining Employees
14	AUST	2	0	2
14	Attorney	5	5	0
14	Paralegal Spec.	5	3	2
14	Bankruptcy Analyst	5	2	3
15	AUST	2	2	0
15	Attorney	4	3	1
15	Paralegal Spec.	5	2	3
15	Bankruptcy Analyst	4	3	1
16	AUST	5	3	2
16	Attorney	16	10	6
16	Paralegal Spec.	11	7	4
16	Bankruptcy Analyst	18	8	10
17	AUST	9	4	5
17	Attorney	14	13	1
17	Paralegal Spec.	12	9	3
17	Bankruptcy Analyst	14	3	11
18	AUST	8	7	1
18	Attorney	8	7	1
18	Paralegal Spec.	12	3	9
18	Bankruptcy Analyst	9	5	4
19	AUST	4	2	2
19	Attorney	3	3	0
19	Paralegal Spec.	6	3	3
19	Bankruptcy Analyst	6	3	3
20	AUST	5	4	1
20	Attorney	7	6	1
20	Paralegal Spec.	7	4	3
20	Bankruptcy Analyst	5	2	3
21	AUST	11	9	2

Region	Job Title	Eligible Employees	Employees Attended Training	Remaining Employees
21	Attorney	16	13	3
21	Paralegal Spec.	17	11	6
21	Bankruptcy Analyst	17	8	9
	Total	701	421	280

**UNITED STATES TRUSTEE MANUAL
BANKRUPTCY FRAUD SCHEMES AND INDICATORS**

Type of Fraud Scheme	Fraud Indicators
Bust-out	<ul style="list-style-type: none"> • Company with a short life • Well-established company with good credit recently taken over by a new group who attempts to hide the change in ownership • Fraudulent financial statements • False credit references • No receivables listed on schedules (cash basis operation) • Scheduled inventory is very low • Warehouse full of high volume, low cost items • Disproportionate liabilities to assets • Mainly temporary employees • Fake social security/taxpayer identification numbers used to obtain credit • Leased equipment • Few local creditors; unsecured debt is primarily comprised of trade creditors • Lulling letters to creditors (mail/wire fraud) • No corporate bank account or existing account has no funds • Cash paid up front to rent location • Same individuals involved in previous "failed companies" • Unusual banking activities (check kiting, bank fraud, money laundering, structured transactions) • Schedules and statement of financial affairs incomplete or not filed • Person unfamiliar with debtor's operations testifies at Section 341 meeting • Taxes not paid • The same attorney repeatedly represents these types of debtors
Bleed-outs	<ul style="list-style-type: none"> • Recent changes of ownership/new players • People with no prior involvement in business have money transferred to them, both pre-petition and during bankruptcy • Changes in accounting or cash flow practices for no apparent business reason • Payment stream to a certain creditor suddenly balloons • Sudden decrease in inventory; sharp increase in aged receivables • Inventory, equipment, and machinery are sold a short time before the case is filed

	<ul style="list-style-type: none"> • Capital infusions of corporate officers are renamed "loans" and are paid back • Excessive salaries and bonuses • Complicated asset transfers with no purpose • Depleted pension funds • Leveraged buyouts • Employee contributions for health care and pension funds are diverted and converted for personal use by the debtor • New company is formed just prior to or immediately after the bankruptcy case is filed • The same attorney repeatedly represents these types of debtors
Ponzi (Investor Fraud) Scheme	<ul style="list-style-type: none"> • Numerous contacts from investors/creditors about the case • List of creditors, schedules, and statement of financial affairs show mostly unsecured debt owed to numerous individuals • No prospectus or the prospectus provided is untruthful • Numerous complex investment vehicles, such as limited partnerships • Enormous management or general partnership fees to insider controlled companies • Monthly operating reports show income is from individuals with little or no other outside income • Lulling letters to investors explaining that the delay in their interest/loan/deal payment is outside the control of the manager and, if they will be patient or continue to send money, the problems will be resolved
Health Care And Welfare Fraud	<ul style="list-style-type: none"> • Numerous complaints of poor or non-existent services • Adverse publicity by media about operations • Investigations by regulators of operations • Lack of normal books and records • Unlicensed shelters, rehabilitation facilities, halfway houses, etc. • Deductions from employee paychecks for health care coverage, but funds not remitted to the insurance company
Rent/Equity Skimming	<ul style="list-style-type: none"> • Failure to make mortgage payments • Transfer of entire or fractional interest to property shortly before foreclosure • Multiple fractional interests in real property listed on the schedules • Frequent quit claim deeds transferring interest in the property • Numerous "doing business as" designations and individuals in the chain of the title • Use of mail drop boxes as company business addresses • Post petition transfers into a bankruptcy estate • New corporation formed holding a single asset • Schedules amended to dramatically increase number

	<ul style="list-style-type: none"> • of pieces of real property owned by the debtor • Same individual files claims in large number of unrelated cases. Proofs of claim do not have supporting documentation attached • Debtor complains about the unusual and menacing harassment by a creditor, and counsel takes no court action against the creditor • Unusual provisions in cash collateral orders • Agreements by the debtor to modify the automatic stay to permit foreclosure without any assertion that the lender is under secured
Concealment And False Statements	<ul style="list-style-type: none"> • Claims of theft or large gambling losses just before bankruptcy • Inability to account for property listed on insurance policies or personal financial statements in existence before bankruptcy • Incomplete schedules - frequent amendments in response to creditor questions • Unexplained change in financial circumstances • Debtor shows no ownership interest in residence • Tax returns not filed for the relevant years • Unsecured debt does not reconcile with assets listed, <u>e.g.</u>, large number of medical bills, but no lawsuit listed • Failure to list prior bankruptcies • Significant amendments to list of creditors after Section 341 meeting • Complaints by ex-employees, ex-spouses, or ex-partners about hidden or omitted assets • Fifth Amendment claimed on any issue • Fire or other disaster occurs (of particular importance if arson is suspected) • Transfer of property to relatives or friends just before bankruptcy • Sudden appearance of loans or loan repayments to friends or relatives with little or no documentation • Sudden change of attorney for no apparent reason. • Debtor "confused" about his/her assets and financial affairs
Collusive Involuntary Bankruptcy	<ul style="list-style-type: none"> • Debtor who is subject to a 180-day bar on refiling has an involuntary filed against him/her • Creditors have recently acquired the claim asserted in the involuntary • "Professional" creditors who reappear regularly in suspicious sounding deals • Same attorney is involved in the voluntary and involuntary bankruptcies • Creditors are "former" long-term business associates of the debtor's insider • Insider has filed several suspicious bankruptcy cases for corporate or partnership entities in a short period of

	time
Straw Buyer/Fictitious Bidder	<ul style="list-style-type: none"> • Pre-existing, undisclosed relationship between the debtor and the straw buyer • Sale terms are structured to prefer one bidder • Inadequate or no effort is made to locate other purchasers. Advertising is not placed in appropriate newspapers or journals to reach potential purchasers • Unusually high bid-protection or break-up fees • High price offered, but broad terms allow the purchasers substantial set-off rights • Purchaser is represented by counsel with close ties to the debtor's counsel • Debtor interferes with potential purchasers due diligence efforts • Short notice requested on sale because of "emergency" situation
Serial Filers	<ul style="list-style-type: none"> • Debtor has filed a high number of cases in a short period of time • Debtor does not disclose prior bankruptcy cases • Debtor uses different counsel to file each case • Chapter 13 cases never completed because of failure to fund plan • Debtor had been prohibited from filing a case pursuant to 11 U.S.C. § 109(g)
Fraudulent Petition Mills	<ul style="list-style-type: none"> • Pro se petition where debtor says no one assisted him/her, but the debtor is clearly unfamiliar with the bankruptcy system • A pro se petition is filed and the debtor denies filing bankruptcy • Debtor fails to attend Section 341 meeting • "Face Sheet" filing with a single creditor listed, usually the mortgagee or the landlord • Debtor facing eviction, foreclosure, or repossession notice • Pattern of pro se debtors with identical paperwork as to form, style, and general content • Pattern of complaints from mortgagees or landlords • Debtors or others have been solicited by petition mills that stress stopping evictions • Complaints by debtor that he/she has been making rent/mortgage/car payments to a third party • Advertising in budget papers and using flyers to advertise bankruptcy and divorce assistance at a low, fixed fee • Imply that attorneys are supervising/approving the service • Request payment of filing fee in installments • Assets or liabilities are not scheduled • Failure to properly fill out or file schedules • Use of Chapter 7 when Chapter 13 is clearly feasible.

APPENDIX 7

HANDBOOKS FOR CHAPTERS 7 AND 13 TRUSTEES SECTION 341(A) MEETING OF CREDITORS REQUIRED STATEMENTS/QUESTIONS³⁷

1. State your name, social security number, and current address for the record.
2. Have you read the Bankruptcy Information Sheet provided by the United States Trustee?
3. Did you sign the petition, schedules, statements, and related documents you filed with the court? Did you read the petition, schedules, statements, and related documents before you signed them and is the signature your own?
4. Please provide your picture ID and social security number card for review.
 - a. If the documents are in agreement with the petition, a suggested statement for the record is:

“I have viewed the original driver’s license (or other type of original photo ID) and original social security card (or other original document used for proof) and they match the name and social security number on the petition.”
 - b. If the documents are not in agreement with the petition, a suggested statement for the record is:

“I have viewed the original social security card (or other original document used for proof) and the number is 000-00-0000. It does not match the number on the petition. I have instructed the debtor (or debtor’s counsel) to file an amended petition by [date], serve all creditors and the standing trustee, and send a ‘Notice of Correction of Social Security Number in Bankruptcy

³⁷ The first ten statements/questions are required. The standing trustee shall ensure the debtor answers the substance of each of the ten questions on the record. The standing trustee may exercise discretion and judgment in varying the wording of the statements/questions, if the substance of the questions is covered.

Filing' and a copy of the amended petition to the three major credit reporting agencies and to the United States Trustee."

- c. When the documents do not match the petition, the standing trustee shall attempt to ascertain why. The standing trustee also shall ask if the debtor has ever obtained credit or benefits, such as Medicaid or employment, using the social security number or any other social security number.
 - d. If the debtor did not bring proof of identity and social security number, the standing trustee needs to determine why.
- 5. Are you personally familiar with the information contained in the petition, schedules, statements and related documents?
 - 6. To the best of your knowledge, is the information contained in the petition, schedules, statements, and related documents true and correct?
 - 7. Are there any errors or omissions to bring to my, or the court's, attention at this time?
 - 8. Are all of your assets identified on the schedules?
 - 9. Have you listed all of your creditors on the schedules?
 - 10. Have you filed bankruptcy before using the social security number you presented today, the social security number on the petition or any other social security number not issued by the Social Security Administration? (If so, the standing trustee must obtain the case number and the discharge information to determine the debtor(s) discharge eligibility.)

HANDBOOKS FOR CHAPTERS 7 AND 13 TRUSTEES
SECTION 341(A) MEETING OF CREDITORS
SAMPLE GENERAL QUESTIONS
(TO BE ASKED WHEN DEEMED APPROPRIATE)

1. Do you own or have any interest whatsoever in any real estate?

If owned: When did you purchase the property? How much did the property cost? What are the mortgages encumbering it? What do you estimate the present value of the property to be? Is that the whole value or your share? How did you arrive at that value?

If renting: Have you ever owned the property in which you live and/or is its owner in any way related to you?

2. Have you made any transfers of any property or given any property away within the last one-year period (or such longer period as applicable under state law)? If yes: What did you transfer? To whom was it transferred? What did you receive in exchange? What did you do with the funds?
3. Does anyone hold property belonging to you? If yes: Who holds the property and what is it? What is its value?
4. Do you have a claim against anyone or any business? If there are large medical debts, are the medical bills from injury? Are you the plaintiff in any lawsuit? What is the status of each case and who is representing you?
5. Are you entitled to life insurance proceeds or an inheritance as a result of someone's death? If yes: Please explain the details. If you become a beneficiary of anyone's estate within 6 months of the date of your bankruptcy petition was filed, the trustee must be advised within 10 days through your counsel of the nature and extent of the property you will receive. FRBP 1007(h)
6. Does anyone owe you money? If yes: is the money collectible? Why haven't you collected it? Who owes the money and where are they?
7. Have you made any large payments, over \$600, to anyone in the past year?

8. Were federal income tax returns filed on a timely basis? When was the last return filed? Do you have copies of the federal income tax returns? At the time of the filing of your petition, were you entitled to a tax refund from the federal or state government? If yes: Inquire as to amounts.
9. Do you have a bank account, either checking or savings? If yes: In what banks and what were the balances as of the date you filed your petition?
10. When you filed your petition, did you have:
 - a. Any cash on hand?
 - b. Any U.S. Savings Bonds?
 - c. Any other stocks or bonds?
 - d. Any Certificates of Deposit?
 - e. A safe deposit box in your name or in anyone else's name?
11. Do you own an automobile? If yes: What is the year, make, and value? Do you owe any money on it? Is it insured?
12. Are you the owner of any cash value life insurance policies? If yes: State the name of the company, face amount of the policy, cash surrender value, if any, and the beneficiaries.
13. Do you have any winning lottery tickets?
14. Do you anticipate that you might realize any property, cash or otherwise, as a result of a divorce or separation proceeding?
15. Regarding any consumer debts secured by your property, have you filed the required Statement of Intention with respect to the exemption, retention, or surrender of that secured property? Please provide a copy of the statement to the trustee. Have you performed that intention?
16. Have you been engaged in any business during the last six years? If yes: Where and when? What happened to the assets of the business?
17. Have you seen a credit counselor in the last year?

HANDBOOKS FOR CHAPTERS 7 AND 13 TRUSTEES
SECTION 341(A) MEETING OF CREDITORS
SAMPLE QUESTIONS
(WHEN DEBTORS ARE ENGAGED IN BUSINESS)

1. Who was responsible for maintaining financial records?
2. Which of the following records were maintained?
 - a. Cash receipts journal
 - b. Cash disbursements journal
 - c. General journal
 - d. Accounts receivable ledger
 - e. Accounts payable ledger
 - f. Payroll ledger
 - g. Fixed asset ledger
 - h. Inventory ledger
 - i. General ledger
 - j. Balance sheet, income statement, and cash flow statements
3. Where are each of the foregoing records now located?
4. Who was responsible for preparing financial statements?
5. How often were financial statements prepared?
6. For what periods are financial statements available?
7. Where are such financial statements now located?
8. Was the business on a calendar year or fiscal year?
9. Were federal income tax returns filed on a timely basis? When was the last return filed?
10. Do you have copies of the federal income tax returns? Who have the copies?
11. What outside accountants were employed within the last three years?
12. Do you have copies of the reports of such accountants? Who have the copies?

13. What bank accounts were maintained within the last three years?
14. Where are the bank statements and canceled checks now located?
15. What insurance policies were in effect within the last year? What kind, and why?
16. From whom can copies of such insurance policies be obtained?
17. If the business is incorporated, where are the corporate minutes?
18. If the debtor owed any outstanding accounts receivables? From whom? Are they collectible?
19. Is there any inventory, property, or equipment remaining?

APPENDIX 8

THE EOUST'S DATA ELEMENTS FOR THE CRIMINAL REFERRAL TRACKING SYSTEM

1. Disposition (O=Open or C=Closed)
2. Region
3. Office
4. Judicial District
5. Referral Number
6. District Court Case Number
7. Referral Date
8. Referred By
9. Bankruptcy Number
10. Debtor Name
11. Chapter
12. Allegations
13. Loss
14. Subject Name
15. Subject Aliases
16. Subject Code (e.g. trustee, attorney, debtor)
17. Referred To
18. AUSA Assigned
19. Agent Assigned
20. Date Declined
21. Current Status
22. Date of Action/Response
23. Description of Action/Response
24. Comments
25. Indictment Date
26. Indictment Code
27. Conviction Date
28. Conviction Code
29. Statue of Limitation
30. Prison Time (Sentence)
31. Probation
32. Fine/Restitution
33. Community Service

APPENDIX 9

OIG ANALYSIS OF MISSING AND INCONSISTENT DATA

Data Element	Deficiencies
Office	<ul style="list-style-type: none">For 5,196 cases, the office that made the criminal referral was not identified.
Referral Number	<ul style="list-style-type: none">For 3,486 cases, a referral number was not used.
Referral Date	<ul style="list-style-type: none">For 524 cases, the referral date was not identified.
Referred By	<ul style="list-style-type: none">For 2,985 cases, the source of the referral was not identified.There were 77 different descriptions use to identify the source of the referral such as narrative descriptions, acronyms, and abbreviations.
Bankruptcy Number	<ul style="list-style-type: none">For 1,542 cases, the bankruptcy number was identified.
Debtor Name	<ul style="list-style-type: none">For 1,168 cases, the debtor name was not identified.
Chapter	<ul style="list-style-type: none">For 1,839 cases, the type of chapter filed by the debtor was not identified.
Allegations	<ul style="list-style-type: none">For 358 cases, the type of allegation was not identified.To identify the type of allegation, there were 2,005 different descriptions such as narrative descriptions, acronyms, abbreviations and multiple allegations included in the same data field.
Loss	<ul style="list-style-type: none">For 5,472 cases, the loss was not identified.
Subject Name	<ul style="list-style-type: none">For 1,172 cases, the subject of the criminal referral was not identified.

Data Element	Deficiencies
Subject Code	<ul style="list-style-type: none"> For 3,465 cases, the subject code was not identified. There were 119 different subject codes used because of the inconsistent use of acronyms and abbreviations.
AUSA Assigned	<ul style="list-style-type: none"> For 6,148 cases, AUSA assigned to the cases were not identified.
Date Declined	<ul style="list-style-type: none"> For 15 cases, the date the criminal referral was declined was not identified.
Current Status	<ul style="list-style-type: none"> For 872 cases, the current status was not identified. There were 432 different descriptions used to provide the current status. This occurred because of the inconsistent use narrative descriptions, acronyms, and abbreviations.
Date Indictment	<ul style="list-style-type: none"> For 18 cases, the date of the indictment date was identified.
Indictment Code	<ul style="list-style-type: none"> For 321 cases, the indictment code was not identified. There were 238 different indictment codes used to describe type of indictment. This occurred primarily because of the inconsistent use criminal code citations, narrative descriptions, and the number of offenses.
Date of Conviction	<ul style="list-style-type: none"> For 15 cases, the conviction date was not identified.
Conviction Code	<ul style="list-style-type: none"> For 276 cases, the conviction code was not identified. There were 305 different conviction codes. This occurred primarily because of the inconsistent use criminal code citations, narrative descriptions, and the number of offenses.
Statute of Limitations	<ul style="list-style-type: none"> For 7,554 cases, the date for the statute of limitations was not identified.



APPENDIX 10

U.S. Department of Justice

Executive Office for United States Trustees

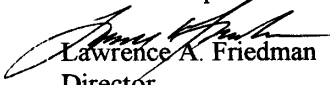
Office of the Director

Washington, DC 20530

February 27, 2003

MEMORANDUM

TO: Guy K. Zimmerman
Assistant Inspector General for Audit

FROM: 
Lawrence A. Friedman
Director

SUBJECT: Draft OIG Report on "The United States Trustee Program's Efforts to Prevent Bankruptcy Fraud and Abuse"

Thank you for the opportunity to review the draft report by the Office of the Inspector General (OIG) on the "United States Trustee Program's Efforts to Prevent Bankruptcy Fraud and Abuse." This report provides important facts and analyses that support the programmatic and management initiatives commenced by the United States Trustee Program (USTP or Program) in calendar year 2001 and reflected in budget submissions by the Bush Administration and Attorney General Ashcroft for Fiscal Years 2002 and 2003. The report clearly identifies the need for enhanced and comprehensive efforts to identify fraud and abuse in the bankruptcy system, and provides several recommendations that will improve our ongoing activities in this critical area.

This response is organized around the two findings made in the OIG report. For each of the findings, the response includes general commentary and then specific action items based upon the recommendations the OIG made related to the finding. In addition, attached is an appendix of technical corrections that we suggest be made to the report before it is issued in final form by the OIG.

Response to Finding #1: Management Controls

The OIG recognized that the USTP has made civil enforcement to combat bankruptcy fraud and abuse its number one priority. The OIG also correctly notes that the Program requires a more "systematic process" and more "uniform internal controls" to identify debtor and other high risk fraud in the bankruptcy system. In particular, the OIG pointed out that the Program should adopt additional management controls to ensure that it is addressing general fraud indicators, rather than place continued emphasis on private trustee fraud which now accounts for only a small portion of all criminal fraud uncovered by the Program. In making this finding, the OIG discusses

several recent important projects launched by the Program to address this pressing need, including the National Civil Enforcement Initiative (NCEI or Initiative), the Debtor Identification Project, bankruptcy petition preparer enforcement activities, and continued leadership in forming district-wide bankruptcy fraud working groups.

The Program largely concurs in the OIG's finding and analysis. It is important to note, however, that despite this Administration's efforts to provide the Program with additional resources, it is not realistic to expect that we ever will enjoy financial and personnel resources sufficient to uncover all civil and criminal fraud and abuse in the bankruptcy system. Insofar as private trustees appointed by the United States Trustees (USTs) administer nearly all of the 1.5 million cases filed each year, it is necessary to rely upon these trustees as a first line in identifying improper conduct. Few, if any, regulatory agencies aim to identify and investigate 100 percent of all potential violations. It is incumbent upon the USTP as the primary bankruptcy enforcement agency, however, to develop, implement, and evaluate rigorous systems to uncover and prosecute fraud and abuse. These systems should ensure severe consequences for wrongdoers and provide a strong deterrent against similar bad conduct by others in the bankruptcy system.

It is important to recognize that the USTP's authority is limited to civil enforcement. When our staff identifies criminal conduct, we refer the matters to United States Attorneys and assist them in prosecuting cases. We are not authorized to conduct criminal investigations or to prosecute cases without express authority from the United States Attorney. Moreover, resource constraints imposed upon the FBI and United States Attorneys have severely limited bankruptcy enforcement.

The initial results of our National Civil Enforcement Initiative are encouraging. In the first full year of this Initiative (Fiscal Year 2002), field offices reported taking 30,000 formal or informal enforcement actions that, together with related activities, resulted in approximately \$160 million in potential additional returns to creditors through debts not discharged and other remedies. This Initiative will remain our major priority in the foreseeable future and we are taking numerous steps to strengthen this effort. The Action Items identified below in response to OIG recommendations are among those important steps.

Action Items to Implement Recommendations

Recommendation #1: Establish uniform management control procedures within UST offices to prevent and detect the more common and higher-risk types of fraud affecting the bankruptcy system, such as concealment of assets and serial filers, and ensure that resources are targeted accordingly.

Action Item #1: Designate civil enforcement coordinators who will oversee the NCEI by, among other things, issuing standard guidance, providing technical assistance and training, and coordinating multi-jurisdictional litigation. Such

guidance will include a description of the best methods to identify the most common forms of abuse.

In the Summer 2002 (during the course of the OIG review), the Director designated two senior USTP staff members to serve the functions described above. Their objective is to enhance the quality of our USTP civil enforcement efforts and to ensure greater consistency in the implementation of the Initiative.

Action Item #2: Establish criminal enforcement coordinators to assist USTP staff in identifying and referring for prosecution cases involving criminal conduct, to prosecute cases as Special Assistant United States Attorneys, and perform related duties.

The Director selected two regional coordinators in January 2003. Subject to available appropriations, the Program will expand the national criminal enforcement unit in 2003.

Action Item #3: Create a debtor audit program.

During July and August 2002, six USTP offices conducted a mini-debtor audit pilot to determine the scope of an expanded audit program that could identify specific instances of fraud and abuse, as well as measure the magnitude of fraud and abuse in the bankruptcy system. The Administration and the Attorney General requested funds from Congress to expand the debtor audits in Fiscal Year 2003, but that request was not funded by Congress.

Action Item #4: Develop a Civil Enforcement Manual that will, among other things, identify indicia of fraud and assist staff in the investigation and civil prosecution of fraud and abuse. This Manual will build upon guidance already contained in the UST Manual.

Action Item #5: Develop advanced civil and criminal enforcement training for Program staff.

In Fiscal Year 2002, seven civil enforcement training programs were delivered to 395 staff members at the Program's National Bankruptcy Training Institute (NBTI) at the National Advocacy Center (NAC).^{1/} In Fiscal Year 2003, at least three civil enforcement related courses are planned that will reach 150 staff members with the next level of training. These courses will build upon the guidance provided by the NCEI coordinators, including the detection and sanctioning of various forms of

^{1/} Since May 2000, 665 staff members have attended at least one civil enforcement training program at the NBTI.

fraud and abuse. In addition, a civil enforcement component is built into nearly all of the USTP-sponsored training programs. Although Congress earmarked \$750,000 for training in Fiscal Year 2002, the Program expended more than \$900,000 for this purpose². Subject to available appropriations, we plan to maintain this high level of activity.

Action Item #6: Provide national training for private case trustees.

Currently, field offices regularly provide training programs for private trustees they oversee, and such training often includes a component on combating fraud and abuse. The Program will require that such training be conducted on a yearly basis. In addition, the Program will, for the first time, provide national training at the NBTI for recently appointed trustees. This training will include a module on bankruptcy fraud and abuse. Finally, the Program will develop a curriculum on fraud and abuse and deliver it to the field to be used in providing local training to private trustees.

Recommendation #2: Expand the existing data system to allow for detection of multiple bankruptcy filings nationwide.

Action Item #7: Develop an ACMS replication data base.

The ACMS case tracking system does not permit nationwide or cross-regional searches. The Program has obligated \$425,000 to provide this capability. Completion will require \$800,000 in additional funding and cannot be completed until the end of Fiscal Year 2005. However, the ability to detect multiple bankruptcy filings may be available by the end of Fiscal Year 2004.

Recommendation #3: Ensure uniform and complete reviews of Final Reports and Final Accounts.

Action Item #8: Reissue (and revise, if appropriate) a protocol governing review of final reports and accounts.

The Program has issued extensive guidance to the field on this matter in the past. In conjunction with the Civil Enforcement Initiative, streamlined procedures were developed so that trustee oversight could be accomplished more efficiently, thereby making additional resources available to uncover non-trustee fraud and abuse. In addition, the Program will seek the assistance of the Bureau of Justice Statistics or other federal statistical agencies in further streamlining the procedures for reviewing

² This figure does not include compensation for three full-time staff members who operate the NBTI.

final reports and accounts. Revised peer review procedures now scheduled for development will also include a section addressing the review of final reports and accounts.

Recommendation #4: Ensure that review procedures for cash receipts and disbursements reports are fully implemented.

Action Item #9: Reissue (and revise, if appropriate) guidance governing the review of chapter 11 Monthly Operating Reports (MORs).

Although this step appears appropriate in light of the OIG Finding and Recommendation, we question whether this action is necessary. Contrary to the suggestion in the OIG report, MORs are routinely reviewed and acted upon. For example, in Fiscal Year 2002, field offices reported filing 4,166 motions to convert or dismiss chapter 11 cases. This represents action in approximately 36 percent of all pending chapter 11 cases. A substantial number of these motions are based upon information gleaned from the standardized MOR review.

Response to Finding #2: Performance Measurement System

The OIG describes the importance of adopting a more reliable “management information system” to track cases in which fraud was identified, to ensure the accuracy of field office reporting, to discern trends, and to measure performance. The OIG also noted in two sections of the report (p. 24 and p. 58) that the Program has not measured the extent of fraud and abuse in the entire bankruptcy system. The OIG focused on the Program’s Criminal Referral Data Base which is insufficiently reliable and upon which the Program generally does not rely in making policy and resource allocation decisions. The Data Base is used only as a rudimentary tracking system and not as a management tool. The OIG analysis contained favorable commentary on recent data collection projects undertaken by the Program, including the new “Significant Accomplishments” data base and new performance measures adopted pursuant to the Government Performance and Results Act (GPRA).

Action Items to Implement Recommendations

*Recommendation #5:*³ Redesign the Criminal Referral Tracking System so that it tracks UST investigations as well as referrals made to law enforcement authorities, and use the system for trend analyses of the types of fraud and caseloads both nationally and regionally.

Action Item #10: Design a study to measure the magnitude of fraud and abuse in the bankruptcy system.

³ OIG Recommendations are misnumbered on pages 65 and 66 of the draft report. The recommendations are renumbered, as appropriate, in this response.

The Program will seek technical guidance from the Bureau of Justice Statistics or other federal statistical agencies to design such a study. Implementation of this recommendation may be limited by available appropriations.

Action Item #11: Explore coordination of the USTP criminal referral data base with the Executive Office for United States Attorneys (EOUSA).

The USTP will consult with EOUSA to explore developing a data base that better tracks the disposition of USTP referrals from investigation through disposition, including United States Attorney declination or sentencing.

Action Item #12: Design a new Criminal Referral Tracking System (CRTS).

In 2002, the CRTS and other Program data bases were transferred into the Information Technology (IT) unit of the Executive Office for United States Trustees. In Fiscal Year 2003, the IT unit will survey users of the CRTS system and redesign the system. The new data base will be designed to serve the purposes described in Recommendations #5. The data base design will incorporate a protocol for local and regional office verification. We anticipate that the data base will be delivered to the field in Fiscal Year 2004.

Recommendation #6: Establish data entry protocols for the Criminal Referral Tracking System to ensure that the data is [sic] complete and consistent.

See Action Item #12.

Recommendation #7: Require regional offices to verify criminal fraud referral data for accuracy, completeness, and consistency prior to submitting the appropriate data to the EOUST.

See Action Item #12. The protocol will require appropriate verification by regional offices.

Recommendation #8: Require the EOUST's staff to spot check fraud referral data submitted by the regional offices to help ensure completeness, uniformity, and accuracy.

See Action Item #12. The protocol will provide for periodic spot checks by EOUST staff.

Recommendation #9: Establish a system or modify the existing system to accurately track civil enforcement actions nationally and to compile performance data on the civil enforcement aspect of the UST Program.

Action Item #13: Establish and refine the Significant Accomplishments data base.

In July 2001, the Program issued the first comprehensive request to measure civil enforcement and other litigation-related work performed in the field by the Program. This reporting system, including accompanying guidance, was refined over time and served as the basis for significant changes in the GPRA measurements reported to Congress. In July 2002, the Program began to develop a web-based system for significant accomplishments reporting. After a pilot phase, the new system is now being rolled out nationwide. By the end of January 2003, one-third of the USTP offices were using the automated reporting system. Additional improvements in 2003 will include a protocol for verification of the accuracy of the data contained in the system. To the extent feasible, the Significant Accomplishments data base and the CRTS will be interactive.

I hope that the commentary provided above and technical corrections suggested in the appendix to this response are helpful to you in preparing a final report. The OIG staff did a commendable job in preparing the report, and the findings and recommendations contained in the report will prove to be extremely valuable to the USTP as it moves forward in its criminal and civil enforcement initiatives.

Please let me know if I may provide additional information.

APPENDIX

SUGGESTED TECHNICAL CORRECTIONS

Page 2, Footnote 1: “In the event that the private trustee is unable or unwilling to serve, the U.S. Trustee is to assume the private trustee’s duties.”

Technical Correction 1: “In the event that the private trustee is unable or unwilling to serve, the U.S. Trustee *may* assume the private trustee’s duties.”

Explanation for Technical Correction 1: Section 322 of the Bankruptcy Code provides that the United States Trustee is eligible to serve as a case trustee in a chapter 7, 12, or 13 case. The Code, however, does not require the United States Trustee to serve as a case trustee. See 11 U.S.C. §§ 701, 1202, and 1302. In addition, the Code prohibits the United States Trustee from serving as a chapter 11 trustee. See 11 U.S.C. § 1104.

Page 14: United States Trustee Organizational Chart.

Technical Correction 2: Substitute the organizational chart included as Attachment 1 to this Appendix.

Explanation for Technical Correction 2: The chart depicted on page 14 is not the official organizational chart approved by Attorney General Ashcroft on May 14, 2002. EOUST was not the source of the chart. In addition, the chart on page 14 reflects that private trustees are employees of the United States Trustee Program. Private trustees are not employees of the United States Department of Justice or the United States Trustee Program.

Page 15, Footnote 8: “A creditors’ committee generally consists of three to eleven unsecured creditors. The creditors’ committee may consult with the Program, trustees, and the bankruptcy courts on matters affecting the administration of the estate.”

Technical Correction 3: “A creditors’ committee generally consists of three to eleven unsecured creditors. The creditors’ committee may consult with the Program, *debtors, and others* on matters affecting the administration of the estate.”

Explanation for Technical Correction 3: 11 U.S.C. § 1102 states that, “A committee of creditors ... shall ordinarily consist of the persons willing to serve, that hold the seven largest claims against the debtor” The statutory duties of a chapter 11 creditors’ committee are set forth in 11 U.S.C. § 1103. The last sentence of the footnote describes the duties of a chapter 7 creditors’ committee as set forth in 11 U.S.C. § 705.

Page 15, Footnote 9: “Creditors may elect Chapter 7 trustees.”

Technical Correction 4: “Creditors may elect Chapter 7 *and Chapter 11* trustees.”

Explanation for Technical Correction 4: Creditors may elect chapter 7 and chapter 11 trustees. 11 U.S.C. § 1104(b).

Page 16: “The court appoints a Chapter 11 trustee upon the request of an interested party or the UST.”

Technical Correction 5: “The court *may direct the United States Trustee to appoint* a Chapter 11 trustee upon the request of an interested party or the UST.”

Explanation for Technical Correction 5: The court orders the appointment of a trustee. The United States Trustee appoints the trustee and the court approves the appointment. 11 U.S.C. § 702 and § 1104(d).

Page 17: “The UST Program is funded by fees assessed against debtors who use the bankruptcy system.”

Technical Correction 6: “The UST Program is *entirely* funded by fees assessed against debtors who use the bankruptcy system.”

Explanation for Technical Correction 6: Statutory fees assessed against debtors are the Program's sole source of funding.

Page 18: “Chapters 12 and 13 Trustees”

Technical Correction 7: The following responsibility should be added to the list of responsibilities enumerated on page 18.

- *The disbursement to creditors of funds collected from the debtors pursuant to the terms of the confirmed plan.*

Explanation for Technical Correction 7: The enumerated list is a list of statutory responsibilities and not fiduciary duties. The language change clarifies that standing trustees are responsible for disbursements under the confirmed plan.

Page 19: “The second category, providing \$82.4 million or 55 percent of the UST Program’s funding, is quarterly fees paid by the Chapter 11 debtors. The other \$7.4 million or 5 percent comes from miscellaneous compensation associated with Chapters 12 and 13 debt collection receipts, and refunds.”

Technical Correction 8: “The second category, providing \$82.5 million or 54 percent of the UST Program’s funding, is quarterly fees paid by the Chapter 11 debtors. The other \$7.4 million or 5 percent comes from miscellaneous compensation associated with Chapters 12 and 13 debt collection receipts.”

Explanation for Technical Correction 8: The dollar amount and corresponding funding percentage were corrected for accuracy. Additionally, the source of funding was corrected.

Page 19: “In FYs 1997 to 2002, the UST Program expended or obligated about \$740 million in total to manage and provide oversight of the bankruptcy system ”

Technical Correction 9: “In FYs 1997 to 2002, the UST Program obligated about \$739 million in total to manage and provide oversight of the bankruptcy system ”

Explanation for Technical Correction 9: \$740 million should be changed to \$739 million. “Expended” should be deleted from every place it appears in the paragraph, and the word “obligated ” should be substituted. Obligations and expenditures have specific legal definitions in connection with appropriation law. Obligations are the amounts of money federal agencies legally set aside to pay for contracts, grants, services, and other items that require the government to make payments. An expenditure is a payment to liquidate the obligation. Obligations are not necessarily equal to expenditures.

Page 20: Chart - “Funds Expended or Obligated by the UST Program, FYs 1997 to 2002.”

Technical Correction 10: Chart - “Funds Obligated by the UST Program, FYs 1997 to 2002.” Changes to the chart should be made as shown below. The changes are in bold.

Explanation for Technical Correction 10: The words “Expended or” should be deleted from the chart title (see Explanation for Technical Correction 9), and the highlighted numbers should be substituted for the numbers in the chart.

Funds Obligated by the UST Program FYs 1997 to 2002			
Category	Administration of Cases	Management and Administration	Total
1997	\$99,569,000	\$8,202,000	\$107,771,000
1998	\$108,540,000	\$9,001,000	\$117,541,000
1999	\$110,737,000	\$8,872,000	\$119,609,000
2000	\$110,706,000	\$10,843,000	\$121,549,000
2001	\$117,735,000	\$8,750,000	\$126,485,000
2002	\$145,717,000	\$0*	\$145,717,000
Total	\$693,004,000	\$45,668,000	\$738,672,000

Source: Actual obligations for FYs 1997 to 2001 according to UST budget documents, and obligated funding for FY 2002 according to UST Program officials.

* Per JMD guidance, as part of a GPRA initiative, the USTP was directed to merge the Management and Administration decision unit into the Administration of Cases decision unit.

Page 20: “For FY 2002 the UST Program had requested \$7.8 million for two fraud and abuse initiatives”

Technical Correction 11: “For FY 2002 the UST Program had requested \$7.8 million for a fraud and *an* abuse initiative”

Explanation for Technical Correction 11: The word “two” should be deleted and the word “a” should be added before fraud and the word “an” should be added before the word abuse. These changes clarify that the request was for one fraud initiative and one abuse initiative.

Page 30: “In cases where money is returned to creditors (asset cases), Chapter 7 trustees receive compensation based on the percentage of the assets collected and reduced to cash”

Technical Correction 12: “In cases where money is returned to creditors (asset cases), Chapter 7 trustees receive compensation based on *a* percentage of the *funds disbursed to creditors*”

Explanation for Technical Correction 12: Chapter 7 trustee compensation is based on disbursements to creditors and not on the percentage of the assets collected. 11 U.S.C. § 326.

Page 30: “However, if the trustees elect to perform the review and uncover assets, they would receive additional compensated for administering the case.”

Technical Correction 13: “However, if the trustees elect to perform the review and uncover assets, they would receive additional *compensation* for administering the case.”

Explanation for Technical Correction 13: The word “compensation” should be substituted for the word “compensated” to make the sentence grammatically correct.

Page 33: “Five referrals were based on judicial proceedings such as adversary proceedings, a rule 2004 meeting”

Technical Correction 14: “Five referrals were based on judicial proceedings such as adversary proceedings, a rule 2004 *examination*”

Explanation for Technical Correction 14: The word “examination” should be substituted for the word “meeting” in the body of the text and in footnote 19. Fed. R. Bankr. P. 2004.

Page 36, Footnote 21: “Creditors must cease all collection efforts for 90 days”

Technical Correction 15: “Creditors must cease all collection efforts”

Explanation for Technical Correction 15: The phrase “for 90 days” should be deleted because the law does not impose a time limitation on the automatic stay. 11 U.S.C. § 362.

Page 64: FY 2002 and 2003 Performance Indicators Chart.

Technical Correction 16: Substitute the Performance Resources Table included as Attachment 2 to this Appendix.

Explanation for Technical Correction 16: The chart depicted is not current.

Page 64, Note “a”: “Section 707 of Title 11 addresses dismissal of bankruptcy cases if debtors cause unreasonable delays that are detrimental to creditors, fail to pay bankruptcy filing fees or charges, fail to file required documentation requested by trustees or USTs, or if the debts are primarily consumer debts. Section 707 also includes substantial abuse of the bankruptcy system, e.g. the debtor's ability to pay.”

Technical Correction 17: “Section 707(a) of Title 11 addresses dismissal of bankruptcy cases if debtors cause unreasonable delays that are detrimental to creditors, fail to pay bankruptcy filing fees or charges, *or* fail to file required documentation requested by trustees or USTs. Section 707(b) includes substantial abuse of the bankruptcy system, e.g., the debtor's *debts are primarily consumer debts and the debtor has an ability to repay.*”

Explanation for Technical Correction 17: The first three causes for dismissal are set forth in 11 U.S.C. § 707(a). Only Section 707(b) addresses substantial abuse. The phrase “if the debts are primarily consumer debts” should be repositioned because the fact that a case consists primarily of consumer debt is a prerequisite for 707(b) application, but it is not a ground for dismissal pursuant to §§ 707(a) or (b).

Page 65: “OIG Recommendations 7 - 11.”

Technical Correction 18: “OIG Recommendations 5 - 9.”

Explanation for Technical Correction 18: The OIG Recommendations beginning on page 65 are misnumbered.

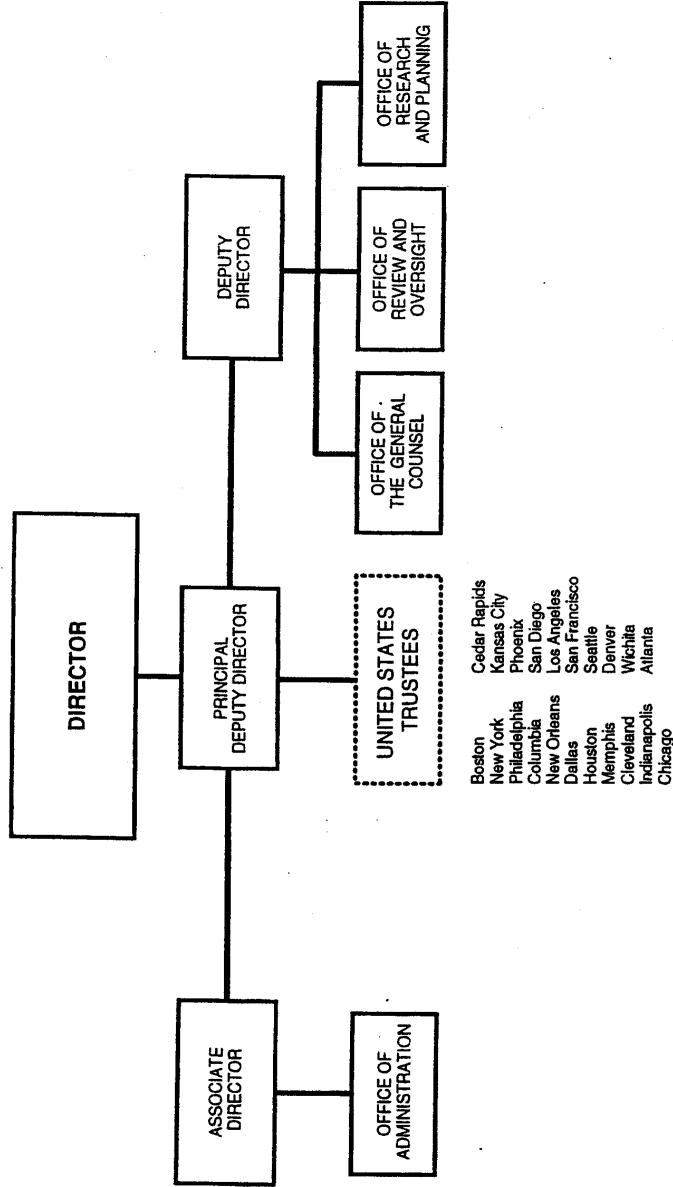
Page 74: “Woodland, CA”

Technical Correction 19: “Woodland *Hills*, CA”

Explanation for Technical Correction 19: The office is located in Woodland Hills, California.

ATTACHMENT 1 TO APPENDIX

EXECUTIVE OFFICE FOR UNITED STATES TRUSTEES





 Approved by: **JOHN D. ASTICROFT**

 Attorney General

Date: 5-14-02

ATTACHMENT 2 TO APPENDIX

Performance Resources Table												
Decision Unit/Program: United States Trustee Program												
DOJ Strategic Goal/Objective: BANKRUPTCY: Protect the Integrity and ensure the effective operation of the Nation's bankruptcy system.												
WORKLOAD/RESOURCES		Actual		FY 2002		FY 2003 Request		Requested			Requested (Total)	
TYPE	Performance Measures/Resources	FY 2001		FY 2002		FY 2003 Request		Current Services Adjustments		FY 2004 Program Change		FY 2004 Enhanced
		FTE	\$000	FTE	\$000	FTE	\$000	FTE	\$000	FTE	\$000	
Strategic Objective	Protect the Integrity and ensure the effective operation of the Nation's bankruptcy system.											
Program Activity	1. Civil Enforcement	69	8,861	128	18,139	210	26,433	10	602	...	...	27,035
Performance Measure	# of motions & complaints & inquiries	13,305		27,457		23,000		1,000		...		24,000
	% of successful motions & complaints	90%		92.1%		85%		2%		...		87%
Program Activity	2. Case and Trustee Administration	FTE 930	\$000 117,573	FTE 908	\$000 127,578	FTE 991	\$000 141,077	FTE ...	\$000 7,060	FTE ...	\$000 ...	148,137
Performance Measure	Chapter 11 # of cases monitored	10,225		11,380		12,000		...		...		12,000
	# of motions & inquiries to convert or dismiss Chapter 11 cases	6,172		8,198		7,000		...		...		7,000
	% of unconfirmed Chapter 11 cases over 3 years old	4.5%		2.7%		<4.5%		...		...		<4.5%
	Chapter 7 # of cases monitored	982,934		1,047,969		1,153,000		69,000		...		1,222,000
	% of Chapter 7 cases over 3 years old	2.20%		2.10%		<3.80%		...		...		<3.80%

	Chapter 13 # of cases monitored	374,133	410,686	451,000	29,000	...	480,000
Outcome:	Payments to Creditors/% of total payments						
	Chapter 7	\$886,229,563 58.6%	\$786,706,213 52.0%	\$786,706,213 54.0%	...	...	\$786,706,213 54.0%
	Chapter 12	\$30,282,131 88.8%	\$25,866,523 75.0%	\$25,866,523 75.0%	...	...	\$25,866,523 75.0%
	Chapter 13	\$3,153,761,306 86.65%	\$2,911,254,306 80.0%	\$2,911,254,306 80.0%	...	...	\$2,911,254,306 80.0%
	Potential Additional Returns to Creditors through Civil Enforcement and Related Efforts	Not Available <i>(Data was not collected in FY 2001)</i>	\$159,010,713	\$159,000,000	...	...	\$159,000,000

Data Definition, Validation, Verification, and Limitations:

Data Definitions:

Chapter 7: A liquidation case. A trustee is appointed to sell the debtor's non-exempt assets and distribute the proceeds to creditors. Generally, absent fraud or abuse, the remaining debts are discharged.

Chapter 11: A reorganization case. The debtor remains in possession of its assets, continues to operate its business, and repays and/or readjusts debts through a plan that must be approved by creditors and the bankruptcy court. Chapter 11 cases are generally business cases.

Chapter 13: A debt readjustment case by an individual with regular income. The debtor retains property, but repays creditors, in whole or in part, through a court approved chapter 13 plan over a period not to exceed 5 years.

Civil Enforcement:

of motions & complaints & inquiries: The number of motions and complaints filed with the court by United States Trustees pursuant to Sections 707, 727, and 110 of the Bankruptcy Code. Section 707(a) of the Bankruptcy Code permits a chapter 7 liquidation case to be dismissed for cause, while Section 707 (b) provides that a case may be dismissed for substantial abuse. Under Section 727, a complaint may be filed objecting to the entry of the chapter 7 debtor's discharge. Section 110 places stringent requirements on all non-lawyers who prepare bankruptcy petitions for compensation and establishes penalties for those individuals who negligently or fraudulently prepare bankruptcy petitions. In addition to formal actions filed with the court, this performance measure also includes the number of inquiries made by United States Trustees under the same Code sections. An inquiry is a written or documented verbal communication by the United States Trustee to a debtor about possible violations on any of these sections, either directly or through a third party such as the case trustee, which requires a response. It does not rise to the level of a formal pleading.

% of successful motions & complaints: The number of motions and complaints filed by the United States Trustees pursuant to Sections 707, 727 and 110 in which the court granted the relief sought, or the debtor/respondent agreed to the relief sought by the United States Trustees divided by the total number of motions/complaints that were filed and resolved.

Case and Trustee Administration:

of cases monitored: The number of new bankruptcy cases filed. This data is provided by the Administrative Office of the U.S. Courts on a quarterly basis.

of motions and inquiries to dismiss or convert chapter 11 cases: The number of motions filed by United States Trustees pursuant to Section 1112 (b) of the Bankruptcy Code. In chapter 11 case administration, the United States Trustees act promptly to file a motion either to dismiss or convert a chapter 11 case to one under chapter 7 if the debtor is not complying with the provisions of the Bankruptcy Code or Rules, or is unable to confirm a plan of reorganization. In addition to the formal motions filed with the court, this performance measure also includes the number of inquiries made by United States Trustees. An inquiry is a written or documented verbal communication by the United States Trustee to the debtor about issues that would be grounds for conversion or dismissal that required a response from the debtor. It does not rise to the level of a formal pleading.

% of unconfirmed Chapter 11 cases over 3 years old: The percentage of chapter 11 cases that do not have a confirmed plan and are more than 3 years old.

Outcomes:

Payments to Creditors: Total dollar amount of disbursements made to creditors in chapters 7, 12, and 13 cases. Note: the data for FY 2002 are not actual. The data are collected on an annual or semiannual basis. For Chapter 7 cases, the USTP receives trustee distributions reports as part of the Final Account on each Chapter 7 case closed during the year. The data are aggregated on a nationwide basis and reported twice a year in January and July. Chapter 13 data are gathered from the standing Chapter 13 trustees' annual reports on a fiscal year basis. Chapter 7 data will be available in March and Chapters 12 and 13 data will be available in April.

% of Total Payments: The percentage of total payments to creditors is calculated by dividing the payments to creditors by either the total receipts of the bankruptcy estate (in chapter 7 cases) or the trust fund (in chapter 12 and 13 cases). Funds that are not distributed to creditors may include private trustee compensation, professional fees, and other administrative costs.

Potential Additional Returns to Creditors through Civil Enforcement Efforts: The average amount of scheduled unsecured debt in a chapter 7 case multiplied by the number of chapter 7 cases where no debt was discharged because of dismissal or conversion of the case, plus the actual amount of debt not discharged because the discharge was denied by the court or waived by the debtor, plus all professional fee reductions, professional fee disgorgements and all fines imposed as a result of "civil enforcement" actions.

APPENDIX 11

OFFICE OF THE INSPECTOR GENERAL, AUDIT DIVISION, ANALYSIS AND SUMMARY OF ACTIONS NECESSARY TO CLOSE THE REPORT

In its response to the draft report, the EOUST stated that the audit report clearly identifies the need for enhanced and comprehensive efforts to identify fraud and abuse in the bankruptcy system, and provides several recommendations that will improve EOUST's ongoing activities in this critical area. Further, the EOUST stated that it largely concurs with our findings and analyses.

The EOUST also stated that despite the current Administration's efforts to provide the program with additional resources, it is not realistic to expect that it will enjoy financial and personnel resources sufficient to uncover "all" civil and criminal fraud and abuse in the bankruptcy system. We indicate on page 29 of the report that the UST Program will never be able to prevent or identify all instances of fraud and abuse. Therefore, the UST Program should focus its resources on higher-risk types of fraud most affecting the bankruptcy system.

Additionally, the EOUST stated that it is important to recognize that the UST Program's authority is limited to civil enforcement and is not authorized to conduct criminal investigations or to prosecute cases without express authority from the United States Attorney. We agree and stated on page 7 of the report that the USTs are responsible for taking legal action (civil) to enforce the requirements of the Bankruptcy Code and referring cases for investigation and criminal prosecution. Further, we indicated on page 46 that criminal investigations and prosecution is the responsibility of law enforcement agencies and the U.S. Attorneys Office.

Finally, the EOUST requested some minor technical changes to the report. We made the requested changes except for the following:

Page 11: "The second category, providing \$82.4 million or 55 percent of the UST Program's funding, is quarterly fees paid by the Chapter 11 debtors. The other \$7.4 million or 5 percent comes from miscellaneous compensation associated with Chapters 12 and 13 debt collection receipts, and refunds."

Technical Correction 8: “The second category, providing \$82.5 million or 54 percent of the UST Program’s funding, is quarterly fees paid by the Chapter 11 debtors. The other \$7.4 million or 5 percent comes from miscellaneous compensation associated with Chapters 12 and 13 debt collection receipts.”

Explanation for Technical Correction 8: The dollar amount and corresponding funding percentage were corrected for accuracy. Additionally, the source of funding was corrected.

OIG Response: Based on the Program’s fiscal year 2003 budget, we adjusted the amount to \$82.5 million. However, the percentage remains at 55 percent. The budget includes refunds as a source of funding.

Page 56: FY 2002 and 2003 Performance Indicators Chart.

Technical Correction 16: Substitute the Performance Resources Table included as Attachment 2 to this Appendix.

Explanation for Technical Correction 16: The chart depicted is not current.

OIG Response: Change not made because the chart was current for our audit period.

The status of the report’s recommendations follows.

Recommendation Number:

1. **Resolved.** This recommendation is resolved based on the EOUST’s agreement to issue guidance, provide technical assistance and training, and coordinate multi-jurisdictional litigation through the designation of civil enforcement coordinators. The guidance will include a description of the best methods to identify the most common forms of abuse. This recommendation can be closed when we received documentation of such guidance.
2. **Resolved.** This recommendation is resolved based the EOUST’s agreement to expand the ACMS system to allow for the detection of multiple bankruptcy filings. This recommendation can be closed when we received documentation that shows that the ACMS system can detect multiple bankruptcy fillings nationwide.

3. **Resolved.** This recommendation is resolved based on the EOUST's agreement to revise or reissue guidance governing the review of final reports and accounts. This recommendation can be closed when we received documentation that shows guidance covering the review of final reports and accounts has been revised or reissued to ensure that the reviews are uniform and complete.
4. **Resolved.** This recommendation is resolved based on the EOUST's agreement to reissue or revise guidance governing the review of Chapter 11 monthly operating reports. This recommendation can be closed when we receive documentation that shows guidance covering the review of Chapter 11 monthly operating reports has been revised or reissued to ensure the reviews are completed.
5. **Resolved.** This recommendation is resolved based on the EOUST's agreement that the current Criminal Referral Tracking System was insufficiently reliable and stated that a new system will be designed to serve the purposes described in the recommendation. This recommendation can be closed when we receive documentation demonstrating that the new Criminal Referral Tracking System will track UST investigations, referrals made to law enforcement, and allow for trend analyses of the types of fraud and caseloads both nationally and regionally.
6. **Resolved.** This recommendation is resolved based on the EOUST's agreement to establish data entry protocols for the Criminal Referral Tracking System. This recommendation can be closed when we receive documentation that the new Criminal Referral Tracking System has incorporated established data entry protocols.
7. **Resolved.** This recommendation is resolved based on the EOUST's agreement to include within the new Criminal Referral Tracking System protocols that will require appropriate verification by regional offices. This recommendation can be closed when we receive documentation that requires regional offices to verify criminal referral data is accurate, complete, and consistent prior to submitting the data to the EOUST.
8. **Resolved.** This recommendation is resolved based on the EOUST's agreement to include within the new Criminal Referral Tracking System protocols that will provide for periodic spot checks by EOUST staff. This recommendation can be closed when we receive

documentation that requires the EOUST's staff to spot check fraud referral data submitted by the regional offices.

9. **Resolved.** This recommendation is resolved based on the EOUST's establishment of the Significant Accomplishments database that tracks civil enforcement actions performed in the field and by the Program. This recommendation can be closed when we received documentation demonstrating that the Significant Accomplishments database accurately tracks civil enforcement actions nationally and compiles performance data on the civil enforcement aspect of the UST Program.